Agenda Item #9
April 1, 2008
**Action**

# MEMORANDUM

TO: County Council

FROM: Robert H. Drummer, Legislative Attorney

SUBJECT: **Action:** Bill 3-08, Personnel – Retirement – Sudan Investments - Restrictions

**Management and Fiscal Policy Committee recommendation (3-0): enact Bill 3-08 as introduced.**

Bill 3-08, Personnel – Retirement – Sudan Investments - Restrictions, sponsored by Councilmembers Elrich, Ervin, Floreen, Leventhal, and Berliner, was introduced on February 12, 2008. See ©1. A public hearing was held on March 4, and a Management and Fiscal Policy Committee worksession was held on March 6.

Bill 3-08 would prohibit the Employees' Retirement System from investing in certain businesses conducting operations in Sudan under certain circumstances. The Bill would require the Board of Investment Trustees (Board or BIT) to direct its investment managers of actively managed separate accounts to divest of certain companies doing business in Sudan in order to influence the Government of Sudan to end the atrocities in Darfur. The Bill would automatically sunset if the recently enacted Federal law authorizing State and local governments to divest of certain companies conducting business in Sudan sunsets.

The crisis in Sudan was outlined last year in an article in the Washington Post with a chronology of events at ©10 and an article at ©11-16. A recent article in the New York Times indicates that the crisis in Darfur has not improved. See ©17-18.

## Background

The Board was established by County Code §33-59 for the purpose of managing the Trust Fund assets of the three County retirement plans: the Employees' Retirement System (ERS), the Retirement Savings Plan (RSP), and the Deferred Compensation Plan (DCP). There are some important distinctions among the plans. The ERS is a defined benefit plan for public safety employees, and for non-public safety employees hired before October 1, 1994. The Trust Fund includes contributions from both the County and employees as well as investment earnings from those contributions. In FY07, the County contributed $109 million and employees contributed $16 million. Participants in this plan receive a pension at retirement based upon their salary and their years of service. The RSP is a defined contribution plan covering non-public safety employees hired on or after October 1, 1994. The RSP also includes contributions from both the County and employees. In FY07, the County contributed $11 million and employees contributed $7 million. Participants in the RSP have a choice of investment funds selected by the Board or may select other funds through the Self Directed Brokerage Window, and they receive retirement income based upon the value of their individual account. The DCP includes only employee contributions and also provides a choice of investment funds selected by the Board, or employees may select other funds through the Self Directed Brokerage Window.

Section 33-60 requires the Board to retain investment managers to select individual stocks, bonds, and other securities for the ERS Trust Fund. Section 33-61C establishes a standard of care for the Board in exercising its fiduciary duties based upon the common law duties of loyalty and prudence that is similar to the fiduciary duties mandated for private retirement plans by the Federal Employee Retirement Income Security Act (ERISA).

In response to a request from Councilmembers and the Executive, the Board reviewed the issue of divestment of certain companies doing business in Sudan. A copy of the Board's response is attached at ©19-21. The Board, after consultation with the County Attorney's Office, concluded that its current authority does not permit it to consider non-economic criteria in its investment decisions. The Board also listed a series of problems it believes use of non-economic criteria would create. Bill 3-08 would expressly authorize and require the Board to divest of certain companies doing business in Sudan.

**Sudan Accountability and Divestment Act of 2007**

State and local laws requiring the divestment of holdings in companies doing business in Sudan or other nations have recently been challenged in court on the basis of Federal preemption. The Supreme Court struck down a Massachusetts statute that required the state to boycott certain companies doing business with or in Burma in *Crosby v. National Foreign Trade Council*, 530 US 363 (2000). The Supreme Court struck down the state law, holding that it was preempted by federal statutes imposing sanctions on Burma and therefore violated the Supremacy Clause of the U.S. Constitution. Last year, the U.S. District Court in Illinois issued an injunction against the Illinois Sudan Act in *National Foreign Trade Council v. Giannoulias*, Case No. 06 C 4251, 2007 U.S. Dist. LEXIS 13341 (Feb. 23, 2007). The Illinois statute in question prohibited the state from depositing funds in any financial institution unless it could certify that it did not loan money to the government of Sudan or certain companies doing business in Sudan and also prohibited state and local pension funds from investing in certain companies doing business in Sudan. The Court held that this statute violated the Supremacy Clause and the Foreign Commerce Clause of the U.S. Constitution.

In response to these decisions, Congress enacted the Sudan Accountability and Divestment Act of 2007 late last year. See ©22-33. The President signed this Act into law on December 31, 2007. The Act expressly authorizes state and local governments to divest in companies doing business in Sudan and grants investment managers who implement these laws immunity from suit under certain circumstances. The Act establishes guidelines for the state or local government to follow in taking these divestment actions. The Act also requires a state or local government to submit written notice describing a Sudan divestment law to the Attorney General of the United States within 30 days after the enactment of the law. Bill 3-08 is consistent with the guidelines for divestment laws authorized by the Sudan Accountability and Divestment Act of 2007.

## Other Sudan Divestment Laws

The Sudan Divestment Task Force is an organization that promotes the campaign to encourage asset managers to divest holdings in certain companies doing business in Sudan. See the Task Force Information Sheet at ©34. The Sudan Divestment Task Force recently reported that 22 states and 15 local governments have enacted laws aimed at preventing investments by public retirement plans in certain companies doing business in Sudan.

The Maryland General Assembly enacted the 2007 Darfur Protection Act, effective July 1, 2007, (codified at State Personnel & Pensions Art. §21-123.1) covering the State retirement systems. See ©35-41. This statute requires the State retirement system Board of Trustees to divest of certain companies conducting business in Sudan based upon a list of factors set forth in the statute. The State Retirement and Pension System of Maryland recently released a report describing its experience with this new law. The Board reported that it retained a consultant, Institutional Shareholder Services, to provide a monthly list of companies doing business in Sudan. The consultant identified 41 companies, 7 of which were owned in the trust fund. As of June 30, 2007, the Board had instructed its managers to avoid making new investments in any of the 41 companies identified by the consultant, as the statute requires, but had not yet divested any of the 7 companies already held. A copy of the report is attached at ©42-48.

## Bill 3-08

Bill 3-08 generally follows the targeted divestment model championed by the Sudan Divestment Task Force and the guidelines for State and local divestment laws contained in the Federal Sudan Accountability and Divestment Act of 2007. Divestment actions would be limited to actively managed separate accounts in the Employees Retirement System trust fund. The Board would be authorized to retain a professional consultant and review publicly available information in order to determine which companies should be subject to divestment. Bill 3-08 would limit divestment to companies with business operations in Sudan that involve supplying military equipment, oil related activity, mineral extraction activity, or power production activity. The Board would be required to provide each company written notice and an opportunity to respond prior to deciding to take divestment action. Bill 3-08 also contains certain exemptions from divestment action for certain companies doing business in Sudan based upon the exemptions outlined in the Federal Sudan Accountability and Divestment Act of 2007.

Bill 3-08 would also require the Board to report annually to the Council and the Executive on the operation and compliance with the law. Finally, Bill 3-08 contains a sunset provision that would automatically occur 30 days after the President of the United States makes certain findings concerning the government of Sudan. This sunset provision is identical to the sunset provision in the Federal Sudan Accountability and Divestment Act of 2007.

## The Public Hearing

Kelda Simpson, Chair of the BIT, testified concerning the estimated costs of divestment from companies doing business in Sudan. Ms. Simpson also pointed out that the Bill could conflict with the fiduciary duties of loyalty and prudence contained in Code §33-61C.

Compliance with this Bill would require the Board and its investment managers to consider non-economic factors in making investment decisions. Ms. Simpson suggested that the Bill clarify whether it modifies the fiduciary duties codified in §33-61C. See ©49-50.

Brian Banks from the Sudan Divestment Task Force testified at the hearing in support of the Bill. Mr. Banks pointed out that the targeted divestment model embodied in the Bill requires divestment of only the worst offending companies. The Task Force also provides free technical support for pension funds implementing the targeted divestment model for companies doing business in Sudan.

Bess Teller of the Jewish Community Relations Council (See ©51), Harriett Shugerman (See ©53), and Maria Sebastian of the Students for change in Darfur also testified in support for the Bill.

The Council received Resolution 2008-19 of the Council of the City of Takoma Park, Maryland supporting Bill 3-08. See ©54.

## Issues

### 1. Is Bill 3-08 unconstitutional?

Although the Federal preemption issue has been resolved by the enactment by Congress of the Sudan Accountability and Divestment Act of 2007, other legal issues remain. The landmark case in Maryland concerning the fiduciary duty of a trustee for a public retirement plan is *Board of Trustees v. Mayor & City Council of Baltimore City*, 317 Md. 72 (1989). The Maryland Court of Appeals upheld a city ordinance requiring the city pension systems to divest all holdings of companies doing business in South Africa in order to protest the government-sponsored apartheid system in South Africa.[1] The trustees argued that the legislation was an unlawful delegation of legislative power to private persons. Although the ordinance required the trustees to determine which companies were doing business in South Africa by reference to a changing list adopted by a private organization, the Court rejected the unlawful delegation argument by holding that the ordinance permitted the trustees to determine for themselves which companies were doing business in South Africa. Bill 3-08 also requires the BIT to decide which companies to divest from and is therefore not an unlawful delegation of legislative power.

The trustees in *Board of Trustees v. Mayor & City Council of Baltimore City* also argued that the divestment law violated the Contract Clause of the United States Constitution, Art. I, §10. The Court rejected this impairment of contracts argument relying on a factual finding by the trial court that the ongoing cost of compliance to the beneficiaries would be approximately 1/20 of 1% of their assets on a continuing basis. The Court held that this cost did not significantly alter the duty of prudence that was part of the pension contract with the employees because it was *de minimis*. It is difficult to predict how the Court would apply this undefined *de minimis*

[1] Bill 23-86 created the ERS Trust Fund and the Board of Trustees in 1986 and also included a prohibition against investments in companies doing business in South Africa and Namibia. This divestment provision was repealed after the end of the apartheid system in 1993.

standard to the Sudan divestment required by Bill 3-08 since we cannot predict the likely total cost to the ERS.

The Baltimore City pension plan subject to the Court decision was primarily a defined benefit plan with a small variable benefit component that could be affected by investment returns. The ERS is a defined benefit plan where the amount of the pension is not affected by future investment returns. This difference in the plans supports a conclusion that Bill 3-08 does not impair the contract rights of the beneficiaries. The Court held that the common law duty of prudence does not require a fiduciary to blindly seek out the highest possible investment returns, but rather to seek out a just and reasonable return without undue risk. Bill 3-08 is limited to actively managed funds and does not significantly restrict the universe of available investments. It is the opinion of Council staff that Bill 3-08 does not unconstitutionally impair the contract rights of the ERS beneficiaries.

**The Committee agreed (3-0) that Bill 3-08 should be enacted despite this issue.**

2. **What is the cost of divestment to the Trust Fund and the County?**

There are three components to costs associated with divestment. First, there is the cost of administering the program. Bill 3-08 would require the Board to notify each company targeted for possible divestment and give the company an opportunity to respond. The Board would then have to determine if divestment is warranted under the law. In addition, the Board may need to retain a professional consultant to assist it in compiling a list of companies doing business in Sudan and evaluating responses from targeted companies.

The second component is the potential loss of investment returns. It is impossible to predict future returns from any investment portfolio, but there is some evidence that past returns for a "Sudan free" portfolio are lower than its benchmark index. KLD Research & Analytics, Inc. (KLD) is a private company that operates a fee-based research and investment service that tracks companies to avoid in a targeted divestment approach recommended by the Sudan Divestment Task Force. KLD also tracks the returns of a large cap Sudan Free Social Index of equities against the Russell 1000 equity index. According to KLD, the investment returns for the Sudan free index have lagged behind the Russell 1000 since January 1, 2007 (9.30% against 7.85%). See ©55. Wilshire Consulting has tracked a Sudan free portfolio against a benchmark index over the past 5 years and reports a lower return of the Sudan free portfolio for different types of equities ranging from 0 .1% to 0 .42%. See ©56. The Fiscal Impact Statement estimates that a 0.1% decrease in the investment returns for the ERS requires an annual increase in the County's contribution of $2,700,000. See ©57-58.

The third potential cost of divestment is the transaction cost for selling assets before the investment manager would normally do so. This would likely occur in the first year or two as the Board sells targeted companies. Finally, certain successful investment managers may decline to accept the County's business with these restrictions or raise the fees they charge for actively managed funds to cover the cost of compliance. It is difficult to determine if this will occur.

The Fiscal Impact Statement estimates the annual cost of compliance with Bill 3-08 to be between $47,000 and $66,000. See ©58.

3. **Should divestment legislation include commingled fund investments?**

The Maryland Save Darfur Act expressly excludes "indexed funds, private equity funds, real estate funds, or other commingled or passively managed funds" from the eligible accounts that must divest certain companies doing business in Sudan. This appears to be a common provision in other similar laws. An investor in such a commingled fund has no ability to dictate divestment to the fund manager, and therefore can only divest by selling the fund itself. Bill 3-08 would exclude commingled or passively managed funds. This exclusion also increases the universe of alternative investments and supports the conclusion above that Bill 3-08 is constitutional.

***The Committee recommended (3-0) that this exclusion be retained.***

4. **Is the divestment of companies doing business in Sudan likely to be effective?**

There are at least two schools of thought on this issue. The Sudan Divestment Task Force argues that the government of Sudan has historically been vulnerable to targeted economic pressure. They point to a successful divestment campaign against a Canadian oil company, Talisman, in 2002. Talisman's withdrawal from Sudan was followed by other oil companies. The Task Force points out that the Khartoum government soon thereafter began negotiations that ended the country's 21-year civil war. The Task Force also points to a 2006 public relations campaign funded by the government of Sudan challenging the divestment movement, including a $1 million advertisement in the New York Times. A Swiss engineering firm, ABB Ltd., suspended operations in Sudan last year following dialogue with the Task Force. Finally, the Task Force argues that the share prices of companies targeted by the divestment movement should go down in the future. See Task Force Argument for Targeted Divestment at ©59-60.

Opponents of social investing argue that the share price of a company is controlled by the market. A drop in price due to divestment by large fund managers will create a temporary profitable trading opportunity that market participants will exploit and ultimately force the price back up. Opponents also argue that divestment leads to less diversification and thereby adversely affects investment returns in the long run. Some research studies examining the share prices of companies doing business in South Africa in the 1980's conclude that the share prices of the targeted companies did not drop as a result of the divestment campaign. See Alicia H. Munnell, *Should Public Plans Engage in Social Investing?* Center for Retirement Research at Boston College, August 2007, attached at ©61-76.

5. **Should the Bill be amended to clarify the applicable fiduciary duty of loyalty and prudence?**

Social investing occurs when an investment manager applies non-economic criteria to the standard financial analysis of individual investment alternatives in order to promote a social, environmental, or political objective. Bill 3-08 requiring the divestment of holdings in certain companies doing business in Sudan is an example of social investing.

The Office of the County Attorney provided comments on Bill 3-08 in a Memorandum dated February 26, 2008. See ©77-78. The Memorandum points out that the Federal Sudan Accountability and Divestment Act of 2007 grants qualified immunity to ERISA fiduciaries for Sudan divestment decisions only if they follow a 1994 Department of Labor interpretive bulletin concerning social investing. See 29 CFR 2509.94-1 at ©79-80. Although these ERISA standards do not apply to government pension plans such as the ERS, the fiduciary standards established in Code §33-61C for the ERS are similar to these ERISA standards. Under the Department of Labor interpretive bulletin, a fiduciary can consider non-economic factors only if the investment ultimately chosen would be equal or better to alternative available investments judged solely on its economic value. Therefore, the Office of the County Attorney recommended in its written comments that the Bill be amended to clarify that the fiduciary duties set forth in §33-61C are modified by this law. However, Associate County Attorney Amy Moskowitz withdrew this recommendation at the worksession.

Council staff agrees that the fiduciary duty established by §33-61C would be modified by Bill 3-08 to the limited extent that investments in certain companies doing business in Sudan would be prohibited. In fact, the indemnification provision contained on lines 155 and 156 of the Bill supports this interpretation of Bill 3-08. Council staff does not agree that the amendment suggested in the written comments submitted by the Office of the County Attorney is necessary because it is implied by the current language of the Bill.

**The Committee agreed (3-0) to recommend enactment of the Bill without an amendment clarifying that the fiduciary duties established by §33-61C are modified by this law.**

6. **Where does the Council draw the line for social investing?**

Social investing goes far beyond foreign policy issues. The July-August 2003 Issue of *Harvard Magazine* reported that the University has a standing student-faculty Advisory Committee on Shareholder Responsibility to advise its investment committee as to how to vote on shareholder proxy initiatives for stocks that the University owns. This Committee screened 108 shareholder proposals in 2003 raising such topics as genetically engineered food, nuclear power, secondhand smoke in restaurants, and the availability of drugs to treat disease in Africa. The Committee also delves into issues involving corporate governance.

The Maryland Save Darfur Act contains a preamble that sets forth a position that divestment of public funds from certain companies should be limited to instances of genocide, such as the horrors of Darfur. Yet, legislation is currently pending in the General Assembly that would extend divestment to certain companies doing business in Iran. There are also advocacy groups for divestment of public pension funds in companies doing business in other countries. A casual search of the internet yielded websites devoted to divestment of companies doing business in Iran, Burma, Syria, North Korea, Saudi Arabia, and Israel.

Bill 3-08 raises the issue of doing the same for other countries or issues because it would be the only such restriction on investments. The next proposed restriction on investments can enter the policy debate without the stigma of going first. As the list of companies that are on the prohibited investment list grows, the potential costs of divestment also grow. This can increase the likelihood that these costs exceed the *de minimis* test established by the Maryland Court of Appeals in *Board of Trustees v. Mayor & City Council of Baltimore City* and consequently increases the likelihood that the Court will hold that these restrictions impair the contract rights of the beneficiaries.

**The Committee agreed (3-0) that the atrocities in Sudan justify this unique restriction on *the investment authority of the BIT.***

7. **Should the Bill be amended to add an uncodified section requiring notice of this law be sent to the United States Attorney General?**

The Office of the County Attorney recommends that an uncodified section be added to the Bill to require notice to the United States Attorney General within 30 days after the enactment of this Bill. This is a requirement of the Federal Sudan Accountability and Divestment Act of 2007. Council staff agrees that this notice is a requirement of this Federal law, but does not agree that it should be contained in an uncodified section of the law. This is a one time notice requirement that can be accomplished by the Executive Branch without being contained in the law. Council staff agrees that notice of the enactment of this law should be sent to the Attorney General within 30 days after the Bill is enacted into law.

**The Committee agreed (3-0) that the Executive can send notice of the enactment of this Bill *to the Attorney General of the United States without adding an uncodified directive to Bill* 3-08.**

8. **Should Bill 3-08 include an actively managed separate account created for the Retiree Health Benefits Trust?**

Bill 3-08, as introduced, covers the assets held by the BIT for the Employees' Retirement System only. Expedited Bill 28-07 would create a separate Retiree Health Benefits Trust to be managed by the BIT. Although the initial size of the trust fund may be too small for an actively managed separate account, the BIT would have the authority to hire an investment manager in an actively managed separate account for the Retiree Health Benefits Trust. Expedited Bill 28-07 is tentatively scheduled for Council action at the same time as this Bill. The public policy supporting this Bill for the ERS would also apply to an actively managed separate account for the Retiree Health Benefits Trust. The MFP Committee did not address this issue when it considered this Bill on March 6, 2008 because the Committee had not yet considered Expedited Bill 28-07.

Council staff recommends a conforming amendment that would extend the coverage of this Bill to the Retiree Health Benefits Trust that would be created by Expedited Bill 28-07. The recommended amendment would be as follows:

*Amend lines 86 & 87 as follows:*

*Trust* ***[fund]*** *funds* means the assets held for the Employees' Retirement System and the assets held for the Retiree Health Benefits Trust.

*Delete* [fund] and insert funds in its place on lines 89, 136, and 162.

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Bill No. 3-08
Concerning: Personnel – Retirement – Sudan Investments - Restrictions
Revised: 2/6/08
Draft No. 11
Introduced: February 12, 2008
Expires: August 12, 2009
Enacted: ______
Executive: ______
Effective: ______
Sunset Date: ______
Ch. ____, Laws of Mont. Co. ______

# COUNTY COUNCIL
# FOR MONTGOMERY COUNTY, MARYLAND

By: Councilmembers Elrich, Ervin, Floreen, Leventhal and Berliner

**AN ACT** to:

(1) prohibit the Employees' Retirement System from investing in certain businesses conducting operations in Sudan under certain circumstances; and

(2) generally amend the law governing retirement and investments.

By adding

Montgomery County Code
Chapter 33, Personnel and Human Resources
Section 33-60A

By amending

Montgomery County Code
Chapter 33, Personnel and Human Resources
Section 33-61A

| | |
|---|---|
| **Boldface** | *Heading or defined term.* |
| <u>Underlining</u> | *Added to existing law by original bill.* |
| **[**Single boldface brackets**]** | *Deleted from existing law by original bill.* |
| Double underlining | *Added by amendment.* |
| **[[**Double boldface brackets**]]** | *Deleted from existing law or the bill by amendment.* |
| * * * | *Existing law unaffected by bill.* |

*The County Council for Montgomery County, Maryland approves the following Act:*

**Sec. 1. Section 33-60A is added as follows:**

**33-60A. Sudan Investments – Restrictions**

(a) *Definitions.* In this Section, the following words have the meanings indicated:

*Actively managed separate account* means assets held in a separate account by an investment manager hired by the Board. *Actively managed separate account* does not include an indexed fund, private equity fund, real estate fund, mutual fund, or other commingled or passively managed fund.

*Board* means the Board of Investment Trustees established by Section 33-59.

*Company* means any sole proprietorship, organization, association, corporation, partnership, joint venture, limited partnership, limited liability partnership, limited liability company, or other entity or business association, including any wholly-owned subsidiary, majority-owned subsidiary, and parent company of any of them, or business association, that exists for profit-making purposes.

*Divestment action* means selling, redeeming, transferring, exchanging, or otherwise disposing of, and refraining from further buying of, certain investments.

*Doing* or *does business in Sudan* means maintaining equipment, facilities, personnel, or other apparatus of business or commerce in Sudan, including ownership of real or personal property in Sudan:

(1) for the purpose of:

(A) engaging in any business activity with the Government of Sudan; or

(B) conducting business with any company in which the Government of Sudan has a direct or indirect equity share; or

(C) participating in a Government of Sudan-commissioned consortium or project; and

(2) if the business operation includes:

(A) supplying military equipment in Sudan; or

(B) oil-related activities constituting more than 10% of the entity's operations in Sudan; or

(C) mineral extraction activities constituting more than 10% of the entity's operations in Sudan; or

(D) power production activities constituting more than 10% of the entity's operations in Sudan.

*Government of Sudan* means the government in Khartoum, Sudan, led by the National Congress Party (formerly known as the National Islamic Front), or any successor government formed on or after October 13, 2006 (including the coalition National Unity Government agreed upon in the Comprehensive Peace Agreement for Sudan). *Government of Sudan* does not include the regional government of southern Sudan.

*Marginalized populations of Sudan* means adversely affected groups in regions authorized to receive assistance under section 8(c) of the Darfur Peace and Accountability Act (Public Law 109-344) or areas in Northern Sudan described in section 4(9) of that Act.

*Military equipment* means:

(1) weapons, arms, military supplies, and equipment that readily may be used for military purposes, including radar systems or military-grade transport vehicles; or

(2) supplies or services sold or provided directly or indirectly to any force actively participating in armed conflict in Sudan.

*Mineral extraction activity* means exploring, extracting, processing, transporting, or wholesale selling or trading any elemental mineral or associated metal alloy or oxide (ore), including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc.

*Oil-related activity* means exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading oil; or constructing, maintaining, or operating a pipeline, refinery, or other oilfield infrastructure. *Oil-related activity* does not include the retail sale of gasoline or related consumer products in Sudan or leasing or owning rights to an oil block in Sudan.

*Power production activity* means any business operation that involves a project commissioned by the National Electricity Corporation of Sudan or any similar Government of Sudan entity whose purpose is to facilitate power generation and delivery, including establishing any power-generating plant or hydroelectric dam, selling or installing components of any such plant or dam, or providing service contracts related to installing or maintaining any such plant or dam.

*Substantial action* means:

(1) adopting, publicizing, and implementing a formal plan to cease business operations in Sudan within one year and to refrain from any such new business operations;

(2) undertaking significant humanitarian efforts in conjunction with an international organization, the Government of Sudan, the regional government of southern Sudan, or a non-profit entity that is evaluated and certified by an independent third party to be

substantial in relationship to the company's business operations in Sudan and of benefit to one or more marginalized populations of Sudan; or

(3) engaging the Government of Sudan for the purpose of materially improving conditions for the victimized populations in Darfur.

*Trust fund* means the assets held for the Employees' Retirement System.

(b) *Review of investments.* The Board must review the investment holdings in each actively managed separate account of the trust fund and identify each investment in any company that does business in Sudan. The Board must review its investment holdings in these accounts periodically and update the list of companies doing business in Sudan at least every 6 months.

(c) *Divestment.* The Board:

(1) must take divestment action with regard to investments in any company doing business in Sudan within 12 months after the Board finds that the company is doing business in Sudan; and

(2) must not make any new investments in an actively managed separate account in any company that does business in Sudan.

(d) *Research.* In determining if any company does business in Sudan, the Board may:

(1) retain a professional consultant; and

(2) review publicly available information regarding companies doing business in Sudan, including information provided by a non-profit organization, research firm, international organization, or government.

(e) *Exemption.* The divestment or investment prohibition under this Section must not apply to a company that can demonstrate that its business operations in Sudan:

(1) are conducted under contract directly and exclusively with the regional government of southern Sudan;

(2) are conducted under a license from the federal Office of Foreign Assets Control, or are expressly exempted under Federal law from the requirement to be conducted under such a license;

(3) consist of providing goods or services to marginalized populations of Sudan for at least 75% of its business operations in Sudan;

(4) consist of providing goods or services to an internationally recognized peacekeeping force or humanitarian organization;

(5) consist of providing goods or services that are used only to promote health or education; or

(6) have been voluntarily suspended.

(f) *Notice.* The Board:

(1) before taking any divestment action under this Section, must provide written notice and an opportunity to comment in writing to each company subject to the action;

(2) must not take the divestment action until 90 days after written notice is provided to the company; and

(3) must not take the divestment action if the company shows that it:

(A) is not doing business in Sudan;

(B) has taken substantial action, as defined in subsection (a); or

(C) is exempt from divestment under subsection (e).

(g) *Report.* The Board must report annually to the Council and Executive on the operation of and compliance with this Section. The report must:

(1) identify each investment in a company doing business in Sudan held in an actively managed separate account of the trust fund;

(2) list each divestment action taken under this Section; and

(3) calculate the administrative cost of compliance.

(h) *Sunset.* This Section expires 30 days after the President of the United States certifies to Congress that the government of Sudan has honored its commitments to:

(1) abide by United Nations Security Council Resolution 1769 (2007);

(2) cease attacks on civilians;

(3) demobilize and demilitarize the Janjaweed and associated militias;

(4) grant free and unfettered access for delivery of humanitarian assistance; and

(5) allow for the safe and voluntary return of refugees and internally displaced persons.

**Sec. 2. Section 33-61A is amended as follows:**

**33-61A. Indemnification of trustees**

(a) *Authorized.* The County must indemnify every member of the Board who is or may become a party to any action, suit, or proceeding, including administrative and investigative proceedings, [by reasons] because of service as a member of the Board, including any action taken to comply with Section 33-60A, subject to the conditions stated in this Section.

*　　　*　　　*

**Sec. 3. Initial review.** The Board of Investment Trustees must complete its initial review of the investment holdings in all actively managed separate accounts of the trust fund and identify all investments in companies doing business in Sudan within 90 days after the effective date of this Act.

*Approved:*

Michael J. Knapp, President, County Council — Date

*Approved:*

Isiah Leggett, County Executive — Date

*This is a correct copy of Council action.*

Linda M. Lauer, Clerk of the Council — Date

## LEGISLATIVE REQUEST REPORT

Bill 3-08
Personnel – Retirement – Sudan Investments - Restrictions

| | |
|---|---|
| **DESCRIPTION:** | This Bill would prohibit the Employees' Retirement System from investing in certain businesses conducting operations in Sudan under certain circumstances and generally amend the law governing retirement and investments. |
| **PROBLEM:** | On September 25, 2006, the United States Congress reaffirmed that "the genocide unfolding in the Darfur region of Sudan is characterized by acts of terrorism and atrocities directed against civilians, including mass murder, rape, and sexual violence committed by the Janjaweed and associated militias with the complicity and support of the National Congress Party–led faction of the Government of Sudan." On December 31, 2007, President George W. Bush signed the Sudan Accountability and Divestment Act into law. This legislation, which passed both chambers of Congress unanimously, expressly authorizes state and local governments to divest from companies that support the Khartoum government at the expense of marginalized populations in Sudan and grants investment managers certain immunity for taking divestment actions under certain circumstances. |
| **GOALS AND OBJECTIVES:** | The goal of this Bill is to require the County Board of Investment Trustees to require its investment managers of actively managed separate accounts to divest of certain companies doing business in Sudan in order to influence the Government of Sudan to end the atrocities in Darfur. |
| **COORDINATION:** | The Board of Investment Trustees and the County Attorney's Office have reviewed this Bill. |
| **FISCAL IMPACT:** | To be requested. |
| **ECONOMIC IMPACT:** | To be requested. |
| **EVALUATION:** | To be requested. |
| **EXPERIENCE ELSEWHERE:** | The State of Maryland, along with 19 other states and 10 local governments has enacted similar laws requiring divestment of certain companies doing business in Sudan. |
| **SOURCE OF INFORMATION:** | Robert H. Drummer, Legislative Attorney (240-777-7895) |
| **APPLICATION WITHIN MUNICIPALITIES:** | To be researched. |
| **PENALTIES:** | Not applicable. |

# An Evolving Policy on Darfur

**2003**

**Feb. 26** A Darfur rebel group attacks a government police station, an incident widely described as the beginning of a rebellion that eventually will lead to a major humanitarian disaster. By U.N. calculations, more than 2 million people will be made homeless and more than 200,000 people will die.

**2004**

**Sept. 9** Appearing before the Senate Foreign Relations Committee, Secretary of State **Colin L. Powell** becomes the first U.S. official to describe the killings in Darfur as genocide.

*"We concluded — I concluded — that genocide has been committed in Darfur and that the government of Sudan and the Janjaweed bear responsibility — and genocide may still be occurring," Powell says.*

**2005**

**Jan. 31** A U.N. commission investigating atrocities in Sudan concludes that the government did not pursue a policy of genocide in the Darfur region but that Khartoum and government-sponsored Arab militias known as Janjaweed engaged in "widespread and systematic" abuse that may constitute crimes against humanity. The commission recommends that the International Criminal Court pursue war crimes prosecutions.

**July 20** Visiting Sudan, Secretary of State **Condoleezza Rice** defends the administration's policy on Darfur, saying U.S. actions helped "avert some of the humanitarian disaster that was foreseen" a year earlier.

**2006**

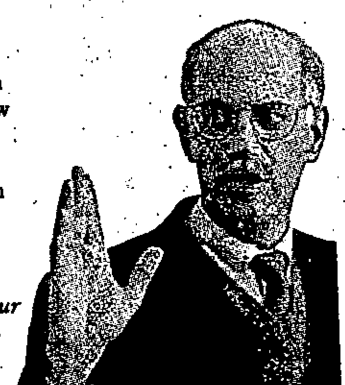
**Feb. 17** **President Bush** calls the NATO secretary general to urge the alliance to play a greater role in Darfur and later tells a Florida audience of his plans.

*"It's going to require . . . a NATO stewardship, planning, facilitating, organizing, probably double the number of peacekeepers that are there now, in order to start bringing some sense of security," Bush says. "There has to be a consequence for people abusing their fellow citizens."*

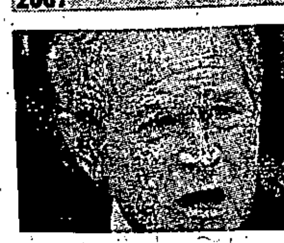
**May 5** The Darfur Peace Agreement is brokered by Deputy Secretary of State **Robert B. Zoellick** between the government of Sudan and the largest rebel group. But other rebel groups refuse to participate, and fighting eventually resumes.

**Sept. 19** In a speech to the United Nations, **Bush** names former USAID administrator **Andrew S. Natsios** (at right) to be special envoy to Sudan with a mandate to help resolve the dispute in Darfur, and warns that Khartoum is obstructing an international force.

*"If the Sudanese government does not approve this peacekeeping force quickly, the United Nations must act," Bush says. "Your lives and the credibility of the United Nations is at stake."*



**2007**



**May 29** **Bush** imposes new sanctions on Sudanese companies to try to pressure Khartoum to accept international peacekeepers in Darfur.

*"For too long, the people of Darfur have suffered at the hands of a government that is complicit in the bombing, murder and rape of innocent civilians," Bush says.*

BY MIKE ABRAMOWITZ AND SETH HAMBLIN — THE WASHINGTON POST

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washingtonpost.com

# U.S. Promises on Darfur Don't Match Actions

Bush Expresses Passion for Issue, but Policies Have Been Inconsistent

By Michael Abramowitz
Washington Post Staff Writer
Monday, October 29, 2007; A01



In April 2006, a small group of Darfur activists -- including evangelical Christians, the representative of a Jewish group and a former Sudanese slave -- was ushered into the Roosevelt Room at the White House for a private meeting with President Bush. It was the eve of a major rally on the National Mall, and the president spent more than an hour holding forth, displaying a kind of passion that has led some in the White House to dub him the "Sudan desk officer."

Bush insisted there must be consequences for rape and murder, and he called for international troops on the ground to protect innocent Darfuris, according to contemporaneous notes by one of those present. He spoke of "bringing justice" to the Janjaweed, the Arab militias that have participated in atrocities that the president has repeatedly described as nothing less than "genocide."

"He had an understanding of the issue that went beyond simply responding to a briefing that had been given," said David Rubenstein, a participant who was then executive director of the Save Darfur Coalition, which has been sharply critical of the administration's response to the crisis. "He knew more facts than I expected him to know, and he had a broader political perspective than I expected him to have."

Yet a year and a half later, the situation on the ground in Darfur is little changed: More than 2 million displaced Darfuris, including hundreds of thousands in camps, have been unable to return to their homes. The perpetrators of the worst atrocities remain unpunished. Despite a renewed U.N. push, the international peacekeeping troops that Bush has long been seeking have yet to materialize.

Just this weekend, peace talks in Libya aimed at ending the four-year conflict appeared to be foundering because of a boycott by key rebel groups.

Many of those who have tracked the conflict over the years, including some in his own administration, say Bush has not matched his words with action, allowing initiatives to drop because of inertia or failure to follow up, while proving unable to mobilize either his bureaucracy or the international community.

The president who famously promised not to allow another Rwanda-style mass murder on his watch has never fully chosen between those inside his government advocating more pressure on Sudan and those advocating engagement with its Islamist government, so the policy has veered from one approach to another.

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Meanwhile, a constant turnover of key administration advisers on Darfur, such as former deputy secretary of state Robert B. Zoellick and presidential aide Michael Gerson, has made it hard for the administration to maintain focus.

"Bush probably does want something done, but the lack of hands-on follow-up from this White House allowed this to drift," said one former State Department official involved in Darfur who did not want to be quoted by name criticizing the president. "If he says, 'There is not going to be genocide on my watch,' and then 2 1/2 years later we are just getting tough action, what gives? He has made statements, but his administration has not given meaning to those statements."

Since the United States became the first and only government to call the killing in Darfur genocide, Bush and his aides have grappled with how to provide security for civilians in a large, remote area in the heart of Africa.

While almost everyone involved in Darfur policy agrees that an African Union peacekeeping force of just 7,000 troops is not up to the task, the United States has refused to send troops and, despite promises of reinforcements, has yet to secure many additional troops from other countries. At the same time, it has been unable to broker a diplomatic resolution that might ease the violence.

Even Bush has complained privately that his hands are tied on Darfur because, with the U.S. involvement in Iraq and Afghanistan, he cannot be seen as "invading another Muslim country," according to people who have spoken with him about the issue.

"It's impossible to keep Iraq out of this picture," said Edward Mortimer, who served as a top aide to then-U.N. Secretary General Kofi Annan and says resentment over Iraq caused many countries to not want to cooperate with the United States on Darfur.

Bush advisers argue that the lack of success reflects the limitations of working through institutions such as the United Nations, NATO and the African Union. They cite the billions of dollars of U.S. relief aid that has kept millions of Sudanese alive. They say U.S. pressure has kept the issue on the world's agenda.

"If there was ever a case study where the president sees the limitations and frustrations of the multilateral organizations, it is the issue of Darfur," said Dan Bartlett, former White House counselor. "Everybody for the most part can come to a consensus: Whether you call it genocide or not, we have an urgent security and humanitarian crisis on our hands. Yet these institutions cannot garner the will or ability to come together to save people."

There is no doubt that responsibility for inaction on Darfur can be spread around. The Sudanese government has resisted cooperation at every step in the saga and has been shielded at the United Nations by China, its main international protector. Few other Western nations, with the notable exception of Britain and some Nordic countries, have shown much interest in resolving the crisis. The process of raising peacekeepers from U.N. members has proved tortuously slow.

"There's an enormous stain on the world's conscience," said Mitchell B. Reiss, former State Department policy planning chief. "We collectively stood by and let it happen a decade after it happened in Rwanda."

**A President's Passion**

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In late 2005, Bush gathered his most senior advisers to discuss what to do about Darfur. He wanted to know whether the U.S. military could send in helicopter gunships to attack the militias if they launched new attacks on the refugee camps. Could they also shoot down Sudanese military aircraft if necessary? he asked. His aides worried that the United States could get involved in another shooting war, and the president backed off.

"He wanted militant action, and people had to restrain him," said one senior official familiar with the episode. "He wanted to go in and kill the Janjaweed."

The meeting underscored both Bush's personal investment in Sudan, dating back to the beginning of his administration, and his instinct, which aides have kept in check, to take direct action.

Many close to Bush believe that this intense interest in the issue was heavily influenced by American evangelicals, who have adopted the cause of Christians in southern Sudan. Even before the crisis in Darfur, in western Sudan, one of Bush's foreign policy goals was to try to end the civil war between the Muslim government in Khartoum and rebels in the south, a conflict that had lasted more than two decades and cost more than 2 million lives.

Former senator John C. Danforth (R-Mo.), whom Bush appointed as his special envoy for Sudan, said the president's interest in the country is rooted in a larger sense of morality. "This isn't a country that has much strategic interest for the United States," he observed.

Bush's initiative to broker a north-south deal worked. Despite difficult negotiations, Sudanese President Omar Hassan al-Bashir agreed in January 2005 to a plan to share power and oil revenues with the rebels -- and even gave the south the right to secede in six years if the leadership could not reconcile their differences.

But by then a separate conflict had exploded in Darfur, as long-standing conflicts between African farmers and Arab herders over land, and a failure by the Khartoum government to redress local grievances, boiled over into armed rebellion.

The government turned to a tactic it had employed in fighting the southern rebels: arming local Arab militias, the Janjaweed, to carry out a counterinsurgency on its behalf. The militias rampaged throughout Darfur starting in mid-2003, burning hundreds of villages, raping women and summarily executing African villagers, according to numerous human rights reports. More than 200,000 people have died in Darfur since the crisis erupted, according to U.N. estimates. Some estimates place the figure as high as 450,000.

Many familiar with Sudan believe that Bush and his aides initially averted their gaze to the flaring violence in Darfur because raising the issue might interfere with the difficult negotiations with Bashir. Some U.S. officials saw another reason for the reluctance to get involved: preserving a burgeoning intelligence relationship with Khartoum, which had begun sharing critical information about al-Qaeda and other Islamic extremists.

"There was a tendency not to see Darfur initially for what it was," said Gerard Gallucci, who served in 2003 and 2004 as the top U.S. diplomat in Khartoum. It was well known among Western governments, he said, that Sudan "was using terror to cleanse black Muslim Africans from land that they had promised the Janjaweed."

Such claims are vigorously contested by Danforth and other Bush advisers, who say the president

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repeatedly warned Bashir about the consequences of sending Arab militias after defenseless civilians.

Over time, Bush has become increasingly outspoken about the situation in Darfur, raising the issue with foreign leaders and meeting privately with dissidents and other little-known political players in Sudan to encourage a solution. In recent months, he has singled out Bashir for harsh condemnation, accusing him of subverting efforts to bring peace to Darfur.

Meeting with the Darfur activists, Bush acknowledged that Sudan had cooperated in anti-terrorism initiatives -- but he insisted that Khartoum could not "buy off" the United States, Rubenstein said.

Last spring, when the White House worked on a new plan to try to press Sudan's government to accept international peacekeepers, it was the president himself who was the driving force in the interagency process, many officials involved the debate said. According to national security adviser Stephen J. Hadley, Bush refused to accept a program developed to confront Sudan because he was concerned that it was not tough enough. He kicked it back to the bureaucracy.

"I've had it with this incrementalism," Hadley quoted the president as saying in the Oval Office. "We're going to lead, and if people don't want to follow us, they're going to have to stand up and explain why they are willing to let women continue to be raped in Darfur."

At one point, one senior official said, Bush wanted action to crimp Sudan's booming oil business, a move that would have severely aggravated relations with China -- and that no one else in the government favored.

There was stunned silence in the room, the official said, when Hadley disclosed Bush's idea to other government officials. Hadley made clear he was not interested in having a discussion, but the administration never went as far as the president seemed to be demanding. Instead, Treasury officials came up with a sanctions plan aimed at tracking and squeezing key individuals and companies in the Sudanese economy, including the oil business.

**Wary of Sending Troops**

At an appearance in Tennessee this summer, Bush raised a question many have asked about the situation in Darfur: "If there is a problem, why don't you just go take care of it?" But Bush said he considered -- and decided against -- sending U.S. troops unilaterally. "It just wasn't the right decision," he said.

With the United States tied down in Iraq and Afghanistan, skepticism about using U.S. soldiers, even in a limited way, cut across agencies and bodies that often disagree, from the State Department to the Pentagon to Vice President Cheney's office, according to many current and former officials.

Advisers say Bush came to accept, albeit grudgingly, the arguments against using U.S. military assets -- especially the possibility that they might attract al-Qaeda. "In my mind, there would never be enough troops to impose order on this place," former secretary of state Colin L. Powell said an interview. "The only way to resolve this problem was for there to be a political settlement between the rebels and the government."

Sharing this belief was Powell's bureaucratic nemesis, then-Defense Secretary Donald H. Rumsfeld, who advocated sending troops to Iraq but not to the middle of Africa, according to many officials in the government.

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This aversion to any use of force was frustrating to some lower-ranking government officials, who saw a modest U.S. military effort as indispensable to making the Sudanese take American diplomacy seriously. Early in the crisis, in the summer of 2004, the U.S. mission in Khartoum made clear to Washington its belief that the African Union was incapable of dealing with the security problem in Darfur on its own.

It recommended that several hundred U.S. troops help fly in African Union forces and provide other assistance, according to a former State Department official. The idea was never seriously entertained, the official said, and it was not until two years later that the United States began making efforts at the United Nations to bolster the overmatched African mission.

Roger Winter, a former State Department official who was intimately involved with Sudan policy during the Bush administration, argues that the United States has never been serious about pressuring the Sudanese government. "They know what we will do and what we won't do," he said. "And they don't respond unless there is a credible threat. And they haven't viewed everything that has happened up until now as credible."

**Carrots vs. Sticks**

Over the course of the conflict, Bush has found himself torn between different factions in his administration over how to handle Sudan -- whether, simply put, to try carrots or sticks.

In early 2006, Bush empowered Zoellick to seek a peace deal between Khartoum and the Darfur rebel groups. Zoellick, now president of the World Bank, was essentially pursuing what one senior U.S. official described as a policy of engagement with the Sudanese government, even though the Bush administration believed it was involved in perpetrating the atrocities in Darfur.

Zoellick worked closely with senior Sudanese officials and dangled the possibility of improved relations and other incentives should Khartoum cooperate in bringing peace to Darfur. And he came close to pulling it off: An agreement to end the violence was negotiated in the spring of 2006, but it fell apart after key rebel leaders refused to sign on.

Some U.S. officials say Bush never completely bought into Zoellick's approach. He seems to have been influenced in that regard by Gerson, the then-speechwriter who was given a wide-ranging policy berth in the early part of Bush's second term.

Gerson, now a Washington Post columnist, is a devout Christian who was especially animated by the part of the Bush agenda that focused on alleviating suffering in Africa. He traveled to Sudan with Zoellick in late 2005, a trip that included a meeting with Bashir, and came back convinced that Khartoum was not seriously interested in efforts to improve conditions in Darfur.

"There was always a series of incremental steps, and nothing changed on the ground," Gerson said later.

Returning to Washington, Gerson told Bush that Bashir was feeling no pressure to cooperate and that the African Union peacekeepers were not up to the task of protecting civilians. He also suggested that it might be useful to establish a no-fly zone to prevent the Sudanese government from flying bombing missions in support of Janjaweed attacks.

Several months later, Gerson sent Bush some articles criticizing the U.S. approach as anemic, and Bush summoned his aide to the Oval Office, a little hot under the collar because he did not agree with the

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criticism. But he assured Gerson, as the former aide remembers, "I want you to know we are acting on this."

In February 2006, Bush proposed using NATO forces to help quickly bolster the beleaguered African Union mission. The president seemed so excited about the idea that he mentioned it, almost casually, in response to a question about Uganda during a public appearance in Florida. The statement stunned some in the U.S. bureaucracy.

But even Bush's efforts to promote the idea did little to move the process along. The French were leery of a new NATO mission outside its normal sphere of operations, and there was no interest from Sudan or the African Union in a major role for this quintessentially Western military alliance, according to U.S. officials. The plan went nowhere.

Now, 20 months later, with Zoellick and Gerson gone, new administration figures are working with other countries on new plans for peace and peacekeepers in Darfur. Given the track record, those who have handled Darfur over the years are cautious.

"Overall," concluded John R. Bolton, the former U.S. ambassador to the United Nations, "Sudan is a case where there's a lot of international rhetoric and no stomach for real action."



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The New York Times
nytimes.com



February 11, 2008

# Attacks Pushing Darfur Refugees Into Chad

By LYDIA POLGREEN

DAKAR, Senegal — Thousands of refugees fleeing attacks by Arab militias and Sudanese Army bombs in the ravaged western region of Darfur have flooded into neighboring Chad, the United Nations said Sunday, and many more may be on their way as Sudan strikes back at a rebel offensive in the area.

The attacks throw a region sundered by conflict into still deeper chaos as a volatile mix of rebels, government forces and ethnic militias jockey to control a vast and unforgiving stretch of semidesert that straddles the two troubled countries. Just a week ago, Chadian rebels based in Sudan tried to topple Chad's government, making it all the way to the gates of the presidential palace in Ndjamena before being beaten back.

Making matters worse, the rebel group that had controlled the part of Darfur under attack, the Justice and Equality Movement, warned the new United Nations-African Union peacekeeping force not to enter the area. The rebels said that the area was an active war zone and that any armed group, including peacekeepers, would be considered hostile and fair game.

"There is no cease-fire, the war is going on," said Suleiman Sandal Haggar, a senior commander with the rebel group, in an interview via satellite phone. "In this situation it is very difficult to talk about peacekeeping when there is no peace to keep."

About 6,000 Sudanese reached the border town of Birak in Chad, said Helen Caux, a spokeswoman for the United Nations refugee agency, and a roughly equal number gathered in a nearby village. The first wave consisted mainly of men. An unknown number of women and children, for whom the voyage on foot is much slower and more deadly, followed, the refugees told the United Nations.

"They are destitute and terrified," Ms. Caux said.

The new arrivals will join the 240,000 Sudanese refugees already in Chad, and a nearly equal number of Chadians who have been displaced by chaos along the border. The influx pushes the number of people in eastern Chad dependent on an already overstretched aid operation toward half a million.

The refugees told United Nations officials of a terrifying assault by Arab militiamen, who arrived on horseback and in trucks, descending on the towns of Sirba, Suleia and Abu Surouj, north of the provincial capital, Geneina, near the border with Chad.

The attacks were apparently an attempt by the Sudanese government to check the advance of the Justice and Equality Movement, which has been gathering strength recently. Once the smallest of the Darfur rebel groups, it has been growing in size and influence, in large part because of its high-level clan links to Chad's president, Idriss Déby, who is its patron and ally.

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The new fighting will further complicate the long-awaited deployment of a United Nations and African Union joint peacekeeping force in Darfur. It officially began its work on Dec. 31, but has been plagued by logistical problems and stonewalling by the Sudanese government.

Speaking to the United Nations Security Council last week after a visit to the region, Jean-Marie Guéhenno, the top United Nations peacekeeping official, warned that "what we are witnessing is actually a war with offensive, counteroffensive fighting."

Jan Eliasson, the United Nations mediator in the region, told the Security Council that "over the last few months, the security and humanitarian situation in Darfur and the region has dramatically deteriorated."

The morass of conflict engulfing the region has become more complex and difficult to control since it first grabbed the world's attention in 2003, when the Arab-dominated government of Sudan unleashed tribal militias known as the janjaweed on non-Arab rebel groups in Darfur. The rebels were seeking greater autonomy and a larger share of Sudan's wealth.

The government-allied militias carried out a brutal counterinsurgency that President Bush and others said was genocide. At least 200,000 people have been killed in Darfur, according to published mortality surveys, and 2.5 million have been driven from their homes.

The Sudanese government has denied that accusation and has said the death toll has been exaggerated.

Since then, the violence has ricocheted into Chad, where ethnic and political tensions mirror those of Darfur. Some of the rebel groups have close ties to Mr. Déby and are allowed to operate freely in Chad. Sudan has retaliated by helping Chadian rebels trying to topple Mr. Déby, according to analysts and diplomats.

Meanwhile, within Sudan, the Darfur rebel groups have splintered and fought among themselves. Some of the Arab militias loyal to the government have also switched sides in the fight more than once.

One result has been a free-for-all that looks less like the 1994 genocide in Rwanda, to which the Darfur conflict has often been compared, and more like a grim combination of the cross-border war that engulfed Congo and its neighbors in the wake of Rwanda's agony and the warlord-ruled chaos of Somalia.

Chadian rebels, meanwhile, said Sunday that they were on the offensive once again, after being routed by government troops and forced to retreat from the capital, Ndjamena.

In a statement posted on a rebel-linked Web site, Ali Ordjo Hemchi, a spokesman for the alliance of three rebel groups seeking to overthrow President Déby, said that the group had taken control of the crossroads town of Am Timan, and seized a cache of weapons and dozens of vehicles.

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2007 OCT 25 AM 8:37

**BOARD OF INVESTMENT TRUSTEES**

October 24, 2007

To: Isiah Leggett, County Executive
Marilyn Praisner, Council President

Re: Divestment from Sudan

The Board of Investment Trustees met on October 19, 2007 to discuss the issue of divestment from certain companies doing business in Sudan, which your offices have asked us to review.

As individuals, members of this Board share the revulsion felt worldwide about the genocide in Darfur conducted by the current government of Sudan. As a Board, we are limited by our investment authority, which comes from the Montgomery County Code. Sections 33-60, 33-125, and 33-145 grant the Board the authority to invest and manage the Trust Fund assets of the County's three retirement plans, the Employees' Retirement System (ERS), Retirement Savings Plan (RSP), and Deferred Compensation Plan (DCP).

Fund assets in the ERS and RSP come from both employees and County taxpayers. Assets in the DCP come solely from employees.

Section 33-60 requires the Board to retain investment managers to choose individual securities, including stocks and bonds. The Board itself cannot select individual securities.

Section 33-61C provides that "a fiduciary must discharge the fiduciary's duties regarding the retirement systems:

- only in the best interest of the participants and their beneficiaries; *[Duty of Loyalty]*
- only to provide benefits to the participants and their beneficiaries, and defray reasonable expenses of administering the retirement systems;
- with the care, skill, prudence, and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with the same matters would use to conduct a similar enterprise with similar purposes; *[Duty of Prudence]*
- by diversifying the investments of the retirement systems to minimize the risk of large losses, unless it is clearly not prudent to diversify under the circumstances;
- according to a good faith interpretation of the law governing the retirement systems;
- according to a good faith interpretation of the documents and instruments governing the retirement systems, if they comply with this Article."

**Montgomery County Employee Retirement Plans**
101 Monroe Street, 15th Floor • Rockville, Maryland 20850
240.777.8220 Fax 301.279.1424

The Duty of Loyalty and Duty of Prudence in the Montgomery County Code derive from the Employees' Retirement Income Security Act (ERISA), which governs private retirement plans and which public pension plans often use as their fiduciary standards. The Department of Labor has repeatedly interpreted the Duty of Loyalty to prohibit fiduciaries "from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." The Department of Labor has also repeatedly stated that the Duty of Prudence prohibits investment decisions from being influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments.

Advocacy groups have targeted many nations, as well as individual companies, for divestment. The County Attorney's Office has advised us that under the Montgomery County Code, the Board does not have the authority to make investment decisions for moral, social, or political reasons (Duty of Loyalty) and must make investments based on economic criteria (Duty of Prudence). In making investment decisions, the Board may consider non-economic criteria only if the resulting investments are equal to or superior to investments based solely on economic criteria. The Board believes it may not be able to meet this test.

The Board is concerned about implementing an investment policy that uses non-economic criteria because it could have the following effects:

- An increase in the County contribution and in the unfunded liability (currently at $700 million) for the ERS due to:
  - potentially lower returns and greater risk. A 0.1% decrease in the ERS' investment return equates to an estimated annual increase of $2,700,000 in the required County contribution;
  - potential termination by existing investment managers who are unwilling to accept portfolio restrictions and the potential inability to hire future managers who share this view;
  - additional costs for monitoring systems and staff resources associated with identifying and certifying companies targeted by a divestment effort and researching and conducting due diligence for any replacement securities or fund; and
  - higher transaction costs from selling or disposing of securities.
- Difficulty in establishing policies that determine whether divestment of a specific security and replacement with another security is prudent.
- Potential creation of fiduciary liability for trustees and potential reluctance to serve on the Board.
- Potential restrictions on the mutual/commingled fund choices available to employees enrolled in the Retirement Savings Plan and the Deferred Compensation Plan, which could result in lower returns and less money available at retirement.

The Duty of Loyalty and the Duty of Prudence in County law require the Board to implement investment policies for the County's three retirement plans that serve the thousands of employees, retirees, and beneficiaries who rely on them. If the Council and the Executive decide to amend the Code to impose investment restrictions with respect to any nation or company, the Board will modify its investment policies accordingly.

Sincerely,

Kelda J.C. Simpson

Kelda J.C. Simpson
Chair

cc: Board of Investment Trustees



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S 2271 ES

110th CONGRESS
1st Session
**S. 2271**

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**AN ACT**

To authorize State and local governments to divest assets in companies that conduct business operations in Sudan, to prohibit United States Government contracts with such companies, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

## SECTION 1. SHORT TITLE.

This Act may be cited as the `Sudan Accountability and Divestment Act of 2007'.

## SEC. 2. DEFINITIONS.

In this Act:

(1) APPROPRIATE CONGRESSIONAL COMMITTEES- The term `appropriate congressional committees' means--

(A) the Committee on Banking, Housing, and Urban Affairs, the Committee on Foreign Relations, and the Select Committee on Intelligence of the Senate; and

(B) the Committee on Financial Services, the Committee on Foreign Affairs, and the Permanent Select Committee on Intelligence of the House of Representatives.

(2) BUSINESS OPERATIONS- The term `business operations' means engaging in commerce in any form in Sudan, including by acquiring, developing, maintaining, owning, selling, possessing, leasing, or operating equipment, facilities, personnel, products, services, personal property, real property, or any other apparatus of business or commerce.

(3) EXECUTIVE AGENCY- The term `executive agency' has the meaning given the term in section 4 of the Office of Federal Procurement Policy Act (41 U.S.C. 403).

(4) GOVERNMENT OF SUDAN- The term `Government of Sudan'--

(A) means the government in Khartoum, Sudan, which is led by the National Congress Party (formerly known as the National Islamic Front) or any successor government formed on or after October 13, 2006 (including the coalition National Unity Government agreed upon in the Comprehensive Peace Agreement for Sudan); and

(B) does not include the regional government of southern Sudan.

(5) MARGINALIZED POPULATIONS OF SUDAN- The term `marginalized populations of Sudan' refers to--

(A) adversely affected groups in regions authorized to receive assistance under section 8(c) of the Darfur Peace and Accountability Act (Public Law 109-344; 50 U.S.C. 1701 note); and

(B) marginalized areas in Northern Sudan described in section 4(9) of such Act.

(6) MILITARY EQUIPMENT- The term `military equipment' means--

(A) weapons, arms, military supplies, and equipment that readily may be used for military purposes, including radar systems or military-grade transport vehicles; or

(B) supplies or services sold or provided directly or indirectly to any force actively participating in armed conflict in Sudan.

(7) MINERAL EXTRACTION ACTIVITIES- The term `mineral extraction activities' means exploring, extracting, processing, transporting, or wholesale selling or trading of elemental minerals or associated metal alloys or oxides (ore), including gold, copper, chromium, chromite, diamonds, iron, iron ore, silver, tungsten, uranium, and zinc.

(8) OIL-RELATED ACTIVITIES-

(A) IN GENERAL- Except as provided in subparagraph (B), the term `oil-related activities' means--

(i) exporting, extracting, producing, refining, processing, exploring for, transporting, selling, or trading oil; and

(ii) constructing, maintaining, or operating a pipeline, refinery, or other oilfield infrastructure.

(B) EXCLUSIONS- A person shall not be considered to be involved in an oil-related activity if--

(i) the person is involved in the retail sale of gasoline or related consumer products in Sudan but is not involved in any other activity described in subparagraph (A); or

(ii) the person is involved in leasing, or owns, rights to an oil block in Sudan but is not involved in any other activity described in subparagraph (A).

(9) PERSON- The term `person' means--

(A) a natural person, corporation, company, business association, partnership, society, trust, any other nongovernmental entity, organization, or group;

(B) any governmental entity or instrumentality of a government, including a multilateral development institution (as defined in section 1701(c)(3) of the International Financial Institutions Act (22 U.S.C. 262r(c)(3))); and

(C) any successor, subunit, parent company or subsidiary of any entity described in subparagraph (A) or (B).

(10) POWER PRODUCTION ACTIVITIES- The term `power production activities' means any business operation that involves a project commissioned by the National Electricity Corporation of Sudan or other similar entity of the Government of Sudan whose purpose is to facilitate power generation and delivery, including establishing power-generating plants or hydroelectric dams, selling or installing components for the project, or providing service contracts related to the installation or maintenance of the project.

(11) STATE- The term `State' means each of the several States, the District of Columbia, the Commonwealth of Puerto Rico, the

United States Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

(12) STATE OR LOCAL GOVERNMENT- The term `State or local government' includes--

(A) any State and any agency or instrumentality thereof;

(B) any local government within a State, and any agency or instrumentality thereof;

(C) any other governmental instrumentality; and

(D) any public institution of higher education within the meaning of the Higher Education Act of 1965 (20 U.S.C. 1001 et seq.).

## SEC. 3. AUTHORITY OF STATE AND LOCAL GOVERNMENTS TO DIVEST FROM CERTAIN COMPANIES DIRECTLY INVESTED IN CERTAIN SUDANESE SECTORS.

(a) Sense of Congress- It is the sense of Congress that the United States Government should support the decision of any State or local government to divest from, or to prohibit the investment of assets of the State or local government in, a person that the State or local government determines poses a financial or reputational risk.

(b) Authority To Divest- Notwithstanding any other provision of law, a State or local government may adopt and enforce measures that meet the requirements of subsection (e) to divest the assets of the State or local government from, or prohibit investment of the assets of the State or local government in, persons that the State or local government determines, using credible information available to the public, are conducting or have direct investments in business operations described in subsection (d).

(c) Notice to Department of Justice- Not later than 30 days after adopting a measure pursuant to subsection (b), a State or local government shall submit written notice to the Attorney General describing the measure.

(d) Business Operations Described-

(1) IN GENERAL- Business operations described in this subsection are business operations in Sudan that include power

production activities, mineral extraction activities, oil-related activities, or the production of military equipment.

(2) EXCEPTIONS- Business operations described in this subsection do not include business operations that the person conducting the business operations can demonstrate--

(A) are conducted under contract directly and exclusively with the regional government of southern Sudan;

(B) are conducted under a license from the Office of Foreign Assets Control, or are expressly exempted under Federal law from the requirement to be conducted under such a license;

(C) consist of providing goods or services to marginalized populations of Sudan;

(D) consist of providing goods or services to an internationally recognized peacekeeping force or humanitarian organization;

(E) consist of providing goods or services that are used only to promote health or education; or

(F) have been voluntarily suspended.

(e) Requirements- Any measure taken by a State or local government under subsection (b) shall meet the following requirements:

(1) NOTICE- The State or local government shall provide written notice and an opportunity to comment in writing to each person to whom a measure is to be applied.

(2) TIMING- The measure shall apply to a person not earlier than the date that is 90 days after the date on which written notice is provided to the person under paragraph (1).

(3) APPLICABILITY- The measure shall not apply to a person that demonstrates to the State or local government that the person does not conduct or have direct investments in business operations described in subsection (d).

(4) SENSE OF CONGRESS ON AVOIDING ERRONEOUS TARGETING- It is the sense of Congress that a State or local government should not adopt a measure under subsection (b) with respect to a person unless the State or local government has made every effort to avoid erroneously targeting the person

and has verified that the person conducts or has direct investments in business operations described in subsection (d).

(f) Definitions- In this section:

(1) INVESTMENT- The `investment' of assets, with respect to a State or local government, includes--

(A) a commitment or contribution of assets;

(B) a loan or other extension of credit of assets; and

(C) the entry into or renewal of a contract for goods or services.

(2) ASSETS-

(A) IN GENERAL- Except as provided in subparagraph (B), the term `assets' refers to public monies and includes any pension, retirement, annuity, or endowment fund, or similar instrument, that is controlled by a State or local government.

(B) EXCEPTION- The term `assets' does not include employee benefit plans covered by title I of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1001 et seq.).

(g) Nonpreemption- A measure of a State or local government authorized under subsection (b) is not preempted by any Federal law or regulation.

(h) Effective Date-

(1) IN GENERAL- Except as provided in paragraph (2), this section applies to measures adopted by a State or local government before, on, or after the date of the enactment of this Act.

(2) NOTICE REQUIREMENTS- Subsections (c) and (e) apply to measures adopted by a State or local government on or after the date of the enactment of this Act.

## SEC. 4. SAFE HARBOR FOR CHANGES OF INVESTMENT POLICIES BY ASSET MANAGERS.

(a) In General- Section 13 of the Investment Company Act of 1940 (15 U.S.C. 80a-13) is amended by adding at the end the following:

`(c) Limitation on Actions-

`(1) IN GENERAL- Notwithstanding any other provision of Federal or State law, no person may bring any civil, criminal, or administrative action against any registered investment company, or any employee, officer, director, or investment adviser thereof, based solely upon the investment company divesting from, or avoiding investing in, securities issued by persons that the investment company determines, using credible information that is available to the public, conduct or have direct investments in business operations in Sudan described in section 3(d) of the Sudan Accountability and Divestment Act of 2007.

`(2) APPLICABILITY-

`(A) ACTIONS FOR BREACHES OF FIDUCIARY DUTIES- Paragraph (1) does not prevent a person from bringing an action based on a breach of a fiduciary duty owed to that person with respect to a divestment or non-investment decision, other than as described in paragraph (1).

`(B) DISCLOSURES- Paragraph (1) shall not apply to a registered investment company, or any employee, officer, director, or investment adviser thereof, unless the investment company makes disclosures in accordance with regulations prescribed by the Commission.

`(3) PERSON DEFINED- For purposes of this subsection the term `person' includes the Federal Government and any State or political subdivision of a State.'.

(b) SEC Regulations- Not later than 120 days after the date of the enactment of this Act, the Securities and Exchange Commission shall prescribe regulations, in the public interest and for the protection of investors, to require disclosure by each registered investment company that divests itself of securities in accordance with section 13(c) of the Investment Company Act of 1940. Such rules shall require the disclosure to be included in the next periodic report filed with the Commission under section 30 of such Act (15 U.S.C. 80a-29) following such divestiture.

## SEC. 5. SENSE OF CONGRESS REGARDING CERTAIN ERISA PLAN INVESTMENTS.

It is the sense of Congress that a fiduciary of an employee benefit plan, as defined in section 3(3) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(3)), may divest plan assets from, or avoid investing plan assets in, any person the fiduciary determines is conducting or has direct investments in business operations in Sudan described in section 3(d) of this Act, without breaching the responsibilities, obligations, or duties imposed upon the fiduciary by section 404 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104), if--

(1) the fiduciary makes such determination using credible information that is available to the public; and

(2) such divestment or avoidance of investment is conducted in accordance with section 2509.94-1 of title 29, Code of Federal Regulations (as in effect on the day before the date of the enactment of this Act).

## SEC. 6. PROHIBITION ON UNITED STATES GOVERNMENT CONTRACTS.

(a) Certification Requirement- The head of each executive agency shall ensure that each contract entered into by such executive agency for the procurement of goods or services includes a clause that requires the contractor to certify to the contracting officer that the contractor does not conduct business operations in Sudan described in section 3(d).

(b) Remedies-

(1) IN GENERAL- The head of an executive agency may impose remedies as provided in this subsection if the head of the executive agency determines that the contractor has submitted a false certification under subsection (a) after the date the Federal Acquisition Regulation is amended under subsection (e) to implement the requirements of this section.

(2) TERMINATION- The head of an executive agency may terminate a covered contract upon the determination of a false certification under paragraph (1).

(3) SUSPENSION AND DEBARMENT- The head of an executive agency may debar or suspend a contractor from eligibility for

Federal contracts upon the determination of a false certification under paragraph (1). The debarment period may not exceed 3 years.

(4) INCLUSION ON LIST OF PARTIES EXCLUDED FROM FEDERAL PROCUREMENT AND NONPROCUREMENT PROGRAMS- The Administrator of General Services shall include on the List of Parties Excluded from Federal Procurement and Nonprocurement Programs maintained by the Administrator under part 9 of the Federal Acquisition Regulation issued under section 25 of the Office of Federal Procurement Policy Act (41 U.S.C. 421) each contractor that is debarred, suspended, proposed for debarment or suspension, or declared ineligible by the head of an executive agency on the basis of a determination of a false certification under paragraph (1).

(5) RULE OF CONSTRUCTION- This section shall not be construed to limit the use of other remedies available to the head of an executive agency or any other official of the Federal Government on the basis of a determination of a false certification under paragraph (1).

(c) Waiver-

(1) IN GENERAL- The President may waive the requirement of subsection (a) on a case-by-case basis if the President determines and certifies in writing to the appropriate congressional committees that it is in the national interest to do so.

(2) REPORTING REQUIREMENT- Not later than April 15, 2008, and semi-annually thereafter, the Administrator for Federal Procurement Policy shall submit to the appropriate congressional committees a report on waivers granted under paragraph (1).

(d) Implementation Through the Federal Acquisition Regulation- Not later than 120 days after the date of the enactment of this Act, the Federal Acquisition Regulatory Council shall amend the Federal Acquisition Regulation issued pursuant to section 25 of the Office of Federal Procurement Policy Act (41 U.S.C. 421) to provide for the implementation of the requirements of this section.

(e) Report- Not later than one year after the date the Federal Acquisition Regulation is amended under subsection (e) to implement the requirements of this section, the Administrator of General Services, with the assistance of other executive agencies, shall submit to the Office of Management and Budget and the appropriate congressional committees a report on the actions taken under this section.

## SEC. 7. SENSE OF CONGRESS ON EFFORTS BY OTHER COUNTRIES.

It is the sense of Congress that the governments of all other countries should adopt measures, similar to those contained in this Act, to publicize the activities of all persons that, through their financial dealings, knowingly or unknowingly enable the Government of Sudan to continue to oppress and commit genocide against people in the Darfur region and other regions of Sudan, and to authorize divestment from, and the avoidance of further investment in, such persons.

## SEC. 8. SENSE OF CONGRESS ON PEACEKEEPING EFFORTS IN SUDAN.

It is the sense of Congress that the President should--

(1) continue to work with other members of the international community, including the Permanent Members of the United Nations Security Council, the African Union, the European Union, the Arab League, and the Government of Sudan to facilitate the urgent deployment of a peacekeeping force to Sudan; and

(2) bring before the United Nations Security Council, and call for a vote on, a resolution requiring meaningful multilateral sanctions against the Government of Sudan in response to its acts of genocide against the people of Darfur and its continued refusal to allow the implementation of a peacekeeping force in Sudan.

## SEC. 9. SENSE OF CONGRESS ON THE INTERNATIONAL OBLIGATIONS OF THE UNITED STATES.

It is the sense of Congress that nothing in this Act--

(1) conflicts with the international obligations or commitments of the United States; or
(2) affects article VI, clause 2, of the Constitution of the United States.

## SEC. 10. REPORTS ON SANCTIONS IN SUPPORT OF PEACE IN DARFUR.

(a) In General- The Secretary of State and the Secretary of the Treasury shall submit to the appropriate congressional committees a report assessing the effectiveness of sanctions imposed with respect to Sudan at the time the Secretary of State and the Secretary of the Treasury submits reports required under--

(1) the Sudan Peace Act (Public Law 107-245; 50 U.S.C. 1701 note);
(2) the Comprehensive Peace in Sudan Act of 2004 (Public Law 108-497; 50 U.S.C. 1701 note); and
(3) the Darfur Peace and Accountability Act of 2006 (Public Law 109-344; 50 U.S.C. 1701 note).

(b) Additional Report by the Secretary of the Treasury- The Secretary of the Treasury shall submit to the appropriate congressional committees a report assessing the effectiveness of sanctions imposed with respect to Sudan under the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.) at the time the President submits the reports required by section 204(c) of such Act (50 U.S.C. 1703(c)) with respect to Executive Order 13,067 (50 U.S.C. 1701 note; relating to blocking property of persons in connection with the conflict in Sudan's region of Darfur).

(c) Contents- The reports required by subsections (a) and (b) shall include--

(1) a description of each sanction imposed under a law or executive order described in subsection (a) or (b);
(2) the name of the person subject to the sanction, if any; and
(3) whether or not the person subject to the sanction is also subject to sanctions imposed by the United Nations.

## SEC. 11. REPEAL OF REPORTING REQUIREMENT.

Section 6305 of the U.S. Troop Readiness, Veterans' Care, Katrina Recovery, and Iraq Accountability Appropriations Act, 2007 (Public Law 110-28; 121 Stat. 172) is repealed.

## SEC. 12. TERMINATION.

The provisions of sections 3, 4, 5, 6, and 10 shall terminate 30 days after the date on which the President has certified to Congress that the Government of Sudan has honored its commitments to--

(1) abide by United Nations Security Council Resolution 1769 (2007);

(2) cease attacks on civilians;

(3) demobilize and demilitarize the Janjaweed and associated militias;

(4) grant free and unfettered access for delivery of humanitarian assistance; and

(5) allow for the safe and voluntary return of refugees and internally displaced persons.

Passed the Senate December 12, 2007.

Attest:

Secretary.

110th CONGRESS

1st Session

**S. 2271**

**AN ACT**

To authorize State and local governments to divest assets in companies that conduct business operations in Sudan, to prohibit United States Government contracts with such companies, and for other purposes.

*END*

# SUDAN DIVESTMENT
TASK FORCE
A project of the Genocide Intervention Network

PHONE (202) 481-8220
FAX (800) 991-2024
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WEB SITE www.SudanDivestment.org

*"The divestment movement [helps] draw international attention to the appalling situation in Darfur while pressuring the foreign companies working with the murderous Sudanese government to pull out. That could be a catalyst for change in Africa's worst killing zone."*

— The Los Angeles Times Editorial Board, March 2006

California Governor Arnold Schwarzenegger is joined by actor George Clooney and former Secretary of State George Shultz at a public signing for California's targeted Sudan divestment bill.

## WHAT IS THE SUDAN DIVESTMENT TASK FORCE?

As the coordinating entity for the Sudan divestment movement, the Sudan Divestment Task Force supports Sudan divestment campaigns at the university, city state, national, and asset manager levels. The Sudan Divestment Task Force also provides company research and corporate engagement assistance to hundreds of fiduciaries worldwide, representing more than $1.5 trillion in total assets.

## TARGETED DIVESTMENT: AN INNOVATIVE APPROACH TO STOPPING GENOCIDE

The new millennium's first genocide rages unabated into its fifth year in the Darfur region of Sudan. For the first time in history, genocide has been declared while the atrocities are *ongoing*. Although humanitarian groups have courageously assisted the millions of displaced in Darfur, international action has been shamefully underwhelming. The magnitude of the crimes in Darfur combined with the failure of the international community to stem these horrors has given states, cities, and other institutions around the world impetus to act. Divestment is one of the sharpest tools investors have for influencing Sudan's behavior.

The Sudan Divestment Task Force, a project of the Genocide Intervention Network, has developed a uniquely targeted approach to divestment, focusing only on the most egregiously offending companies in Sudan. Since the ultimate intent of Sudanese divestment is to protect the victims of genocide, it is important to tailor divestment so as to have maximal impact on the government of Sudan's behavior, while minimizing potential harm to innocent Sudanese. Divestment should therefore be targeted to those companies that have a business relationship with the government or government-created project, impart minimal benefit to the country's underprivileged, have expressed no significant corporate governance policy regarding the current situation in Darfur *and* have proven unresponsive to attempts at shareholder engagement. Targeted divestment explicitly excludes the vast majority of companies in Sudan, including those tied to the agricultural sector, distribution of general consumer goods, promotion of non-oil-related infrastructure development in underprivileged regions of the country, and those involved in the provision of goods and services intended to relieve human suffering or to promote welfare, health, education, and religious and spiritual activities.

## A GROWING INTERNATIONAL MOVEMENT

Since the movement began in April 2005, more than 50 universities, 15 states, and 5 cities have placed restrictions on their Sudan-linked investments. Active campaigns are now underway in eight countries. In addition to providing research on Sudan-linked companies to fiduciaries around the world, the Sudan Divestment Task Force also works with the asset management community to create Sudan-free investment opportunities.

The Sudan Divestment Task Force has received media coverage on both an international and local level. Featured stories, editorials, and op-eds have appeared in major media outlets, including the New York Times, BBC, Los Angeles Times, Washington Post, Wall Street Journal, Boston Globe, Christian Science Monitor, Financial Times, International Herald Tribune, Forbes Magazine, Bloomberg, CNN, and the San Francisco Chronicle.

# HOUSE BILL 1336

K4 (7lr3071)

*ENROLLED BILL*

*— Appropriations / Budget and Taxation —*

Introduced by **Delegates Branch, Anderson, Benson, Burns, Cane, Davis, Gaines, Glenn, Griffith, Harrison, Holmes, Howard, Jones, Kirk, Levi, Morhaim, Nathan–Pulliam, Oaks, Pena–Melnyk, Proctor, Rice, Stukes, Tarrant, Taylor, F. Turner, Vaughn, and Walker**

Read and Examined by Proofreaders:

______________________________
Proofreader.

______________________________
Proofreader.

Sealed with the Great Seal and presented to the Governor, for his approval this

______ day of ______________ at ______________________ o'clock, _______M.

______________________________
Speaker.

CHAPTER _____

AN ACT concerning

**2007 Darfur Protection Act – Divestiture from the Republic of Sudan**

FOR the purpose of requiring the Board of Trustees of the State Retirement and Pension System to review certain investment holdings; requiring the Board of Trustees to encourage certain companies to take certain actions; requiring the Board of Trustees to provide written notice to certain companies; authorizing the Board of Trustees to take divestment action with regard to certain investments; prohibiting the Board of Trustees from acquiring certain

EXPLANATION: **CAPITALS INDICATE MATTER ADDED TO EXISTING LAW.**
[Brackets] indicate matter deleted from existing law.
Underlining indicates amendments to bill.
~~Strike out~~ indicates matter stricken from the bill by amendment or deleted from the law by amendment.
*Italics indicate opposite chamber / conference committee amendments.*

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securities; requiring the Board of Trustees to take certain issues into account prior to taking certain actions; requiring the Board of Trustees to publish certain reports containing certain information on or before a certain date; defining certain terms; providing for the termination of this Act under certain circumstances; and generally relating to the divestment of investments from the Republic of Sudan.

BY adding to
Article – State Personnel and Pensions
Section 21–123.1
Annotated Code of Maryland
(2004 Replacement Volume and 2006 Supplement)

Preamble

WHEREAS, On September 9, 2004, Secretary of State Colin L. Powell told the United States Senate Foreign Relations Committee that "genocide has occurred and may still be occurring in Darfur" and "the Government of Sudan and the Janjaweed bear responsibility"; and

WHEREAS, On September 21, 2004, addressing the United Nations General Assembly, President George W. Bush affirmed the Secretary of State's finding and stated, "at this hour, the world is witnessing terrible suffering and horrible crimes in the Darfur region of Sudan, crimes my government has concluded are genocide"; and

WHEREAS, On September 25, 2006, the United States Congress reaffirmed that "the genocide unfolding in the Darfur region of Sudan is characterized by acts of terrorism and atrocities directed against civilians, including mass murder, rape, and sexual violence committed by the Janjaweed and associated militias with the complicity and support of the National Congress Party–led faction of the Government of Sudan"; and

WHEREAS, On September 26, 2006, the United States Congress stated that "an estimated 300,000 to 400,000 people have been killed by the Government of Sudan and its Janjaweed allies since the Darfur crisis began in 2003, more than 2,000,000 people have been displaced from their homes, and more than 250,000 people from Darfur remain in refugee camps in Chad"; and

WHEREAS, The Darfur crisis represents the first time the United States Government has labeled ongoing atrocities a genocide; and

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WHEREAS, The federal government has imposed sanctions against the Government of Sudan since 1997, that are monitored through the United States Treasury Department's Office of Foreign Assets Control (OFAC); and

WHEREAS, According to a former chair of the United States Securities and Exchange Commission (SEC), "the fact that a foreign company is doing material business with a country, government, or entity on OFAC's sanctions list is, in the SEC staff's view, substantially likely to be significant to a reasonable investor's decision about whether to invest in that company"; and

WHEREAS, In response to the financial risk posed by investments in companies doing business with a terrorist–sponsoring state, the SEC established its Office of Global Security Risk to provide for enhanced disclosure of material information regarding such companies; and

WHEREAS, Despite significant pressure from the United States government, the Republic of Sudan fails to take necessary actions to disassociate itself from its ties to terrorism and genocide; and

WHEREAS, Companies supporting such ties with terrorism and genocide present further material risk to remaining investors of these companies; and

WHEREAS, It is a fundamental responsibility of the State to decide where, how, and by whom financial resources in its control should be invested, taking into account numerous pertinent factors; and

WHEREAS, It is the prerogative and desire of the State, in respect to investment resources in its control and to the extent reasonable, with due consideration for, among other things, return on investment, on behalf of itself and its investment beneficiaries, not to participate in an ownership or capital–providing capacity with entities that provide significant practical support for genocide, including certain international companies presently doing business in Sudan; and

WHEREAS, It is the judgment of the General Assembly that this Act should remain in effect only insofar as it continues to be consistent with, and does not unduly interfere with, the foreign policy of the United States as determined by the federal government; and

WHEREAS, It is the judgment of the General Assembly that divestment of public funds from certain companies is a measure that should be employed sparingly and judiciously – a United States Congressional and Presidential declaration of genocide satisfying this high threshold; now, therefore,

SECTION 1. BE IT ENACTED BY THE GENERAL ASSEMBLY OF MARYLAND, That the Laws of Maryland read as follows:

**Article – State Personnel and Pensions**

**21–123.1.**

**(A) (1) IN THIS SECTION THE FOLLOWING WORDS HAVE THE MEANINGS INDICATED.**

**(2) "COMPANY" MEANS ANY CORPORATION, UTILITY, PARTNERSHIP, JOINT VENTURE, FRANCHISOR, FRANCHISEE, TRUST, ENTITY, INVESTMENT VEHICLE, FINANCIAL INSTITUTION, OR ITS WHOLLY OWNED SUBSIDIARY;**

**(3) (I) "ACTIVELY MANAGED SEPARATE ACCOUNTS" MEANS THE ACCOUNTS OF THE SEVERAL SYSTEMS THAT ARE ACTIVELY MANAGED AT THE DIRECTION OF THE BOARD OF TRUSTEES AND HELD IN SEPARATE ACCOUNTS.**

**(II) "ACTIVELY MANAGED SEPARATE ACCOUNTS" DOES NOT MEAN INDEXED FUNDS, PRIVATE EQUITY FUNDS, REAL ESTATE FUNDS, ~~AND~~ *OR* OTHER COMMINGLED OR PASSIVELY MANAGED FUNDS.**

**(4) "DIVESTMENT ACTION" MEANS SELLING, REDEEMING, TRANSFERRING, EXCHANGING, OR OTHERWISE DISPOSING OF OR REFRAINING FROM FURTHER INVESTMENT IN CERTAIN INVESTMENTS.**

**(5) "DOING BUSINESS IN SUDAN" MEANS MAINTAINING EQUIPMENT, FACILITIES, PERSONNEL, OR OTHER APPARATUS OF BUSINESS OR COMMERCE IN SUDAN, INCLUDING OWNERSHIP OF REAL OR PERSONAL PROPERTY IN SUDAN, OR ENGAGING IN ANY BUSINESS ACTIVITY WITH THE GOVERNMENT OF SUDAN.**

**(6) "ELIGIBLE ACCOUNTS" MEANS ACTIVELY MANAGED SEPARATE ACCOUNTS CONTAINING FUNDS OF THE SEVERAL SYSTEMS.**

**(7) "INVESTMENT" *MEANS THE COMMITMENT* OF *FUNDS* OR OTHER ASSETS TO A COMPANY, INCLUDING:**

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(I) THE OWNERSHIP OR CONTROL OF A SHARE OR INTEREST IN THE COMPANY; OR

(II) THE OWNERSHIP OR CONTROL OF A BOND OR OTHER DEBT INSTRUMENT BY A COMPANY.

(8) (I) "SUDAN" MEANS THE GOVERNMENT IN KHARTOUM, SUDAN, THAT IS LED BY THE NATIONAL CONGRESS PARTY (FORMERLY KNOWN AS THE NATIONAL ISLAMIC FRONT) OR ANY SUCCESSOR GOVERNMENT FORMED ON OR AFTER OCTOBER 13, 2006, INCLUDING THE COALITION NATIONAL UNITY GOVERNMENT AGREED ON IN THE COMPREHENSIVE PEACE AGREEMENT FOR SUDAN.

(II) "SUDAN" DOES NOT MEAN THE REGIONAL GOVERNMENT OF SOUTHERN SUDAN.

(B) THE BOARD OF TRUSTEES SHALL REVIEW THE INVESTMENT HOLDINGS IN ELIGIBLE ACCOUNTS FOR THE PURPOSE OF DETERMINING THE EXTENT TO WHICH FUNDS IN ELIGIBLE ACCOUNTS ARE INVESTED IN COMPANIES DOING BUSINESS IN SUDAN.

(C) CONSISTENT WITH THE FIDUCIARY DUTIES OF THE BOARD OF TRUSTEES UNDER SUBTITLE 2 OF THIS TITLE, AND THE PROVISIONS OF SUBSECTION (D) OF THIS SECTION, THE BOARD OF TRUSTEES:

(1) SHALL ENCOURAGE COMPANIES IN WHICH ELIGIBLE ACCOUNTS ARE INVESTED AND THAT ARE DOING BUSINESS IN SUDAN TO ACT RESPONSIBLY AND AVOID ACTIONS THAT PROMOTE OR OTHERWISE ENABLE HUMAN RIGHTS VIOLATIONS IN SUDAN;

(2) MAY TAKE DIVESTMENT ACTION IN ELIGIBLE ACCOUNTS WITH REGARD TO INVESTMENTS:

(I) IN ANY COMPANY DOING BUSINESS IN SUDAN; OR

(II) IN ANY SECURITY OR INSTRUMENT ISSUED BY SUDAN; AND

(3) MAY NOT MAKE ANY NEW INVESTMENTS FROM NET NEW FUNDS IN AN ELIGIBLE ACCOUNT IN ANY COMPANY THAT IS DOING BUSINESS IN SUDAN.

(D) IN DETERMINING WHETHER TO TAKE DIVESTMENT ACTION UNDER SUBSECTION (C) OF THIS SECTION WITH REGARD TO THE INVESTMENT OF FUNDS IN ELIGIBLE ACCOUNTS IN A COMPANY DOING BUSINESS IN SUDAN, THE BOARD OF TRUSTEES SHALL CONSIDER THE FOLLOWING:

(1) REVENUES PAID BY A COMPANY DIRECTLY TO THE GOVERNMENT OF SUDAN;

(2) WHETHER A COMPANY SUPPLIES INFRASTRUCTURE OR RESOURCES USED BY THE GOVERNMENT OF SUDAN TO IMPLEMENT ITS POLICIES OF GENOCIDE IN DARFUR OR OTHER REGIONS OF SUDAN;

(3) WHETHER A COMPANY KNOWINGLY OBSTRUCTS LAWFUL INQUIRIES INTO ITS OPERATIONS AND INVESTMENTS IN SUDAN;

(4) WHETHER A COMPANY ATTEMPTS TO CIRCUMVENT ANY APPLICABLE SANCTIONS OF THE UNITED STATES;

(5) THE EXTENT OF ANY HUMANITARIAN ACTIVITIES UNDERTAKEN BY A COMPANY IN SUDAN;

(6) WHETHER A COMPANY IS ENGAGED SOLELY IN THE PROVISION OF GOODS AND SERVICES INTENDED TO RELIEVE HUMAN SUFFERING, OR TO PROMOTE WELFARE, HEALTH, EDUCATION, OR RELIGIOUS OR SPIRITUAL ACTIVITIES;

(7) WHETHER A COMPANY IS AUTHORIZED BY THE FEDERAL GOVERNMENT OF THE UNITED STATES TO DO BUSINESS IN SUDAN;

(8) EVIDENCE THAT A COMPANY HAS ENGAGED THE GOVERNMENT OF SUDAN TO CEASE ITS ABUSES IN DARFUR OR OTHER REGIONS IN SUDAN;

(9) WHETHER A COMPANY IS ENGAGED SOLELY IN JOURNALISTIC ACTIVITIES; AND

(10) ANY OTHER FACTOR THAT THE BOARD OF TRUSTEES DEEMS PRUDENT.

(E) IF THE BOARD OF TRUSTEES TAKES DIVESTMENT ACTION UNDER SUBSECTION (C) OF THIS SECTION, WITH RESPECT TO INVESTMENTS IN A COMPANY, THE BOARD OF TRUSTEES SHALL PROVIDE THE COMPANY WITH WRITTEN NOTICE OF ITS DECISION AND REASONS FOR THE DECISION.

(F) ON OR BEFORE OCTOBER 1 OF EACH YEAR, AND EVERY 3 MONTHS THEREAFTER, THE BOARD OF TRUSTEES SHALL SUBMIT A REPORT IN ACCORDANCE WITH § 2-1246 OF THE STATE GOVERNMENT ARTICLE TO THE SENATE BUDGET AND TAXATION COMMITTEE, THE HOUSE APPROPRIATIONS COMMITTEE, AND THE JOINT COMMITTEE ON PENSIONS THAT PROVIDES:

(1) A SUMMARY OF CORRESPONDENCE WITH COMPANIES ENGAGED BY THE BOARD OF TRUSTEES UNDER THIS SECTION;

(2) ALL DIVESTMENT ACTIONS TAKEN BY THE BOARD OF TRUSTEES IN ACCORDANCE WITH THIS SECTION;

(3) A LIST OF COMPANIES DOING BUSINESS IN SUDAN WHICH THE BOARD OF TRUSTEES HAS DETERMINED TO BE INELIGIBLE FOR INVESTMENTS OF NET NEW FUNDS UNDER SUBSECTION (C)(3) OF THIS SECTION; AND

(4) OTHER DEVELOPMENTS RELEVANT TO INVESTMENT IN COMPANIES DOING BUSINESS IN SUDAN.

SECTION 2. AND BE IT FURTHER ENACTED, That if the President of the United States rescinds or repeals Executive Order 13067, with no further action required by the General Assembly, this Act shall be abrogated and of no further force and effect. Within 5 working days of the President of the United States rescinding or repealing Executive Order 13067, the Board of Trustees for the State Retirement and Pension System shall notify the Department of Legislative Services in writing of the rescission or repeal at 90 State Circle, Annapolis, Maryland 21401.

SECTION 3. AND BE IT FURTHER ENACTED, That, subject to the provisions of Section 2 of this Act, this Act shall take effect July 1, 2007.

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STATE RETIREMENT
*and* PENSION SYSTEM
*of* MARYLAND

STATE RETIREMENT AGENCY
120 East Baltimore Street
Baltimore, MD 21202
Tel: 410-625-5555
1-800-492-5909
TDD/TTY 410-625-5535
www.sra.state.md.us



September 27, 2007

Honorable Ulysses Currie
Chair, Budget and Taxation
Miller Senate Office Building
3 West Wing
11 Bladen Street
Annapolis, MD 21401

Honorable Rona E. Kramer
Co-Chair, Joint Committee on Pensions
Miller Senate Office Building
Room 214
11 Bladen Street
Annapolis, MD 21401

Honorable Norman H. Conway
Chair, Appropriations Committee
House Office Building
Room 121
6 Bladen Street
Annapolis, MD 21401

Honorable Melony Ghee Griffith
Co-Chair, Joint Committee on Pensions
House Office Building
Room 412
6 Bladen Street
Annapolis, MD 21401

Dear Chairmen Currie, Kramer, Conway and Griffith,

As required by the 2007 Darfur Protection Act – Divestiture from the Republic of Sudan, I am submitting the first quarterly report required under the Act. This report, prepared by the State Retirement and Pension System, describes the actions taken by the System as a result of the Act, which is being codified at SPP § 21-123.1 of the Annotated Code of Maryland.

The Act requires that the Board of Trustees review its investments in companies that conduct business in the Republic of Sudan in order to determine if those investments should continue. The Act describes criteria the Board should consider in making their decisions, and actions the Board should take to implement those decisions. In addition, the Act requires that the Board submit a report describing its compliance with the Act to the Senate Budget and Taxation and House Appropriations Committees as well as the Joint Committee on Pensions quarterly.

This report includes the following:

i. A summary of correspondence with companies engaged by the Board of Trustees;

ii. All divestment actions taken by the Board of Trustees;

iii. A list of companies doing business in Sudan which the Board of Trustees has determined to be ineligible for investments of net new funds;

iv. Other developments relevant to investments in companies doing business in Sudan.

Please contact me should you have any concerns or questions regarding this report.

Sincerely,

R. Dean Kenderdine
Executive Secretary

Attachment

Attachment 1

1. A summary of correspondence with companies engaged by the Board of Trustees;

Fall 2006/Winter 2007

The System hired Institutional Shareholder Services (ISS) to provide a monthly list of companies doing business in Sudan. The System received its first list in November, 2006. Engagement letters were initially sent to eleven companies on the list that were believed to be owned in one or more of the portfolios managed for the System by its external managers. The letters requested that the companies provide information regarding their activities in the Republic of Sudan and their plans for staying in Sudan. The letters inquired whether the company would maintain the current level of activity, reduce it or withdraw from the country. Seven companies responded with information about their involvement in Sudan as well as their codes of ethics and social responsibility policies.

The eleven companies engaged were Alcatel-Lucent, Alstom, AMEC LLC, Ericsson Inc., Lukoil OAO, Marathon Oil Corp, Schlumberger Ltd., OAO Tatneft, Terex Corporation, Total SA, and Wartsila Oyj.

Spring 2007

The System sent follow-up letters to the four companies who did not respond to the first letters and to six additional companies. The System also conducted follow up electronic communications with the investor relations departments at some of the companies. The six companies that received their first engagement letter from the System were BAE Systems PLC, BP PLC, Petrochina Company Limited, Rolls-Royce, Royal Dutch Shell PLC, and Siemens AG.

Summer 2007/Fall 2007

The Act took effect July 1, 2007. As a result of the definition of "doing business in Sudan" in Section (A)(5) of the Act, several companies were removed from the ISS list, and several were added. Effective July 1, 2007, no new investment in any company on the ISS list may be made in any Eligible Account. The System has recently sent letters to the six companies on the restricted list that it owned in eligible accounts as of June 30, 2007. These letters have asked the companies to respond to the criteria described in Section (D) of the Save Darfur Act.

The six companies engaged are Alcatel-Lucent, Alstom, Petrofac Ltd., Petrolium Nasional, Schlumberger Ltd. and Total SA.

2. All divestment actions taken by the Board of Trustees

In October 2006, the System hired Institutional Shareholder Services (ISS) to provide a list of companies doing business in Sudan monthly.

In February, 2007, the System informed its managers of Eligible Accounts of the Sudan related legislation and sent them the January 31, 2007, ISS list of companies doing business in Sudan. This was to increase their awareness of the pending legislation and to facilitate their planning.

In April, 2007, the System sent the managers of Eligible Accounts a copy of the Save Darfur Act of 2007. The managers were informed that they would not be required to sell their holdings in the identified companies immediately, but,as of July 1, 2007, they would be restricted from investing any additional funds in any of the companies on the list.

As of June 30, 2007, ISS customized the Maryland Restricted List to meet the definition of "doing business in Sudan" in Section (A)(5) of the Save Darfur Act. At that time, the System owned seven of the 41 companies identified by ISS in Eligible Accounts. The System sent the customized list from ISS to all the managers of Eligible Accounts. The managers will receive the list every month.

In August, the Board of Trustees considered the divestment of the investment in one company, Schlumberger Ltd., an oil field service company domiciled in the Netherland Antilles that is currently operating in the Sudan. In light of (1) recent reports that Schlumberger is making strides to increase its humanitarian response to the situation in Darfur, and (2) the fact that the Save Darfur Task Force (an international watchdog organization described in response to Question 4) has modified its listing of Schlumberger from "Highest Offenders" to "Ongoing Engagement", the Board decided to defer the consideration of divesting the System's assets from Schlumberger Ltd. for up to 90 days.

3. The following companies doing business in Sudan were on the ISS list as of June 30, 2007, and are ineligible for investments of net new funds.

| Company Name | Owned in Eligible Account? |
|---|---|
| Alcatel Lucent | Yes |
| Alstom | Yes |
| Aref Investment Group | |
| Bharat Electronics Ltd. | |
| Bharat Heavy Electicals Ltd. | |
| Bollore | |
| CHC Helicopter Corp. | |
| China Petroleum & Chemical Corp. (Sinopec) | |
| CNPC Hong Kong Ltd. | |
| Dong Feng Motor Group Ltd. | |
| Electricity Generating Public Company (EGCO) | |
| Harbin Power Equipment Co. | |
| ICSA (India) Ltd. | |
| Indian Oil Corporation | |
| Kejuruteraan Samudra Timur Bhd | |
| Kencana Petroleum Bhd | |
| La Mancha Resources Inc. | |
| Lundin Petroleum A | |
| Mangalore Refinery and Petrochemicals Ltd. | |
| Marathon Oil Corp ‡ | |
| MISC Bhd | |
| MMC Corporation Bhd | |
| Muhibbah Engineering (M) Berhad | |
| Nam Fatt Co. Bhd | |
| Oil & Natural Gas Corporation Ltd. (ONGC)- | |
| PECD Bhd | |



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| Company Name | Owned in Eligible Account? |
|---|---|
| Petrochina Company Limited | |
| Petrofac Ltd. | Yes |
| Petroliam Nasional (Petronas) | Yes |
| PSL Ltd. | |
| Reliance Industries Ltd. | |
| Sarawak Enterprise Corp. Bhd | |
| Schlumberger Ltd. | Yes |
| Scomi Group Bhd | |
| Societe des Participations du Commissariat a l'Energie Atomique (Areva) | |
| Sudan Telecom Co. Ltd. (Sudatel) | |
| Sumatec Resources B | |
| Terex Corp. | Yes* |
| Total SA | Yes |
| Wartsila Oyj | |
| | |

Note: Terex Corp was removed from the ISS list effective 8/31/2007; it does not conduct business in Sudan.

4. Other developments.

A. In addition to the research it receives from ISS, independent research conducted by staff, and information received from companies as a result of the System's engagement efforts, staff is obtaining more in-depth research from the Sudan Divestment Task Force.

The Task Force, a project of the Genocide Intervention Network, is actively involved in dozens of Sudan divestment campaigns around the world at the university, asset manager, city, state, and national levels.

The Task Force has pro bono legal support from the law firm of Cooley Godward Kronish LLP and analytical support from the Calvert Group, Ltd.

The Task Force provides company research and corporate engagement assistance to hundreds of fiduciaries worldwide.

The Task Force focuses its engagement and divestment efforts on the most egregiously offending companies in Sudan.

The Task Force believes that this approach, which they call "targeted divestment", helps to maximize impact on the Sudanese government, while minimizing potential harm to both innocent Sudanese civilians and investment returns.

B. At the request of Senator Verna Jones, a member of the Agency's staff participated in a panel session regarding the development and implementation of the 2007 Darfur Protection Act at the NCSL's annual education conference in Boston in August 2007.

**TESTIMONY ON BILL 3-08 – Retirement – Sudan Investment - Restrictions**

Good afternoon, for the record, I am Kelda Simpson, Chair of the Board of Investment Trustees, which oversees the investment programs for the County's three retirement plans. I am here today on behalf of the Board to testify on Bill 3-08, Retirement – Sudan Investment Restrictions.

The proposed Bill would prohibit certain investment managers, hired by the Board of Investment Trustees to invest funds for the Employees' Retirement System Trust, from investing in the financial instruments issued by specific companies that are doing business in Sudan under certain circumstances in order to influence the Government of Sudan to end the atrocities in Darfur.

As individuals, every member of this Board shares the revulsion felt worldwide about the genocide in Darfur conducted by the current government of Sudan. The occurrences documented by the United States government and various humanitarian groups are and should be intolerable in any civilized community. The Board fully understands the efforts of those striving to address this crisis. However, in considering divestment, we would like to bring the following matters to the Council's attention:

- The Board's investment authority comes from the Montgomery County Code and subjects the Board to a Duty of Loyalty and a Duty of Prudence. These duties are the same standards found in the Employees' Retirement Income Security Act (ERISA) which governs private retirement plans. The Department of Labor interprets the Duty of Loyalty to prohibit fiduciaries "from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." The Duty of Prudence prohibits investment decisions from being influenced by non-economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments. The recently enacted federal law, the Sudan Accountability and Divestment Act of 2007, provides that ERISA fiduciaries are still subject to the Department of Labor interpretation of economically targeted investments. Applying the Department of Labor standard (determining if an investment is equal to or superior to another investment) may be difficult or impossible for the Board to determine. The Bill should clarify whether the Council intends for the Board to ignore the currently applicable prudent investor standard in order to divest investments in companies that conduct business with Sudan.

- Divestment comes with associated costs. Those costs may include an increase in the County contribution and in the unfunded liability (currently at $700 million) for the ERS due to:
  - costs for hiring a consultant to search for and certify those companies that may have contacts with or ties to the Sudanese government;
  - staff administrative costs associated with the requirement that we identify the specific involvement companies have in Sudan to

determine if an exemption is warranted. The complexity of the rapidly changing conditions in Sudan and the difficulty in obtaining accurate information on a company's exact involvement in Sudan have been a serious problem for many state pension systems, including the State of Maryland Retirement System;

- staff administrative costs related to screening the managers' portfolios, obtaining and maintaining the list of companies, communicating with the investment managers, determining the impact on the portfolio of any divestment action, and preparing reports;
- transaction costs that would be incurred in the selling of securities and the purchase of replacement securities;
- potential lower returns. Based on the analysis prepared by Wilshire Associates, a national consulting firm, the historical performance of major indices, including the S&P 500, MSCI ACWx-US, and the MSCI Emerging Markets, was negatively impacted when companies with ties to Sudan were eliminated (losses range from 0.10% to 0.48% over one, three and five year periods versus the returns of these indices with the companies included); and
- potential termination of existing investment managers who are unwilling to accept portfolio restrictions and the potential inability to hire future managers who share this view.

We estimate that a 0.1% decrease in the ERS' investment return equates to an estimated annual increase of $2,700,000 in the required contribution from County taxpayers.

The Board feels that it is our fiduciary obligation to bring these matters to the Council's attention. However, if the Council decides to amend the Code to impose the investment restrictions outlined in Bill 3-08, the Board will of course modify its investment policies accordingly.

#3

**Testimony of Bess Teller on Behalf of the Jewish Community Relations Council of Greater Washington in Support of 3-08 Personnel- Retirement - Sudan Investments - Restrictions**
**March 4, 2008**

Good afternoon. My name is Bess Teller. I am a member of the board of the Jewish Community Relations Council of Greater Washington, on whose behalf I am speaking. The JCRC is an organization that represents more than 100,000 Jews who participate in Jewish organizations, synagogues, and agencies throughout Montgomery County. We urge you to support the passage of this bill that will allow our county to do even a small part toward ending the genocide in Darfur.

The Jewish community is deeply concerned and outraged by the ongoing tragedy in Darfur. The U.S. Congress, State Department, and President, as well as other world leaders, have recognized the situation as genocide. The crisis in Darfur is an extreme case whereby a government is responsible for a genocidal campaign against part of its own population. The Janjaweed militia has brutally murdered tens of thousands of civilians in Darfur, with the encouragement and active support of the Sudanese government.

Two and half million people out of Darfur's total population of 6 million have been forced from their homes into internal camps and other squalid places of refuge. Another 300,000 have fled to neighboring Chad. More than 400,000 people have died from violence, disease and other conditions related to forced displacement and insufficient access to humanitarian assistance.

Targeted divestment is the removal of investments in companies that are directly or indirectly helping the Sudanese government to perpetuate genocide. A campaign to divest from Talisman Energy, which was known to be helping Sudan in its civil war with the South, caused their stock to drop by one third and forced them out of Sudan. This divestment campaign, along with sustained diplomatic efforts, hastened the Sudan government's peace agreement with the South in 2005 and is illustrative of how divestment affects the Sudanese government's behavior.

Currently more than seven states, including the state of Maryland, and numerous municipalities, academic and other institutions, have chosen to disengage themselves financially from the businesses that are fueling Sudan's genocide in Darfur. We urge you to vote in favor of this legislation which would require selected divestment of Montgomery County pension funds from the companies that are most directly involved in the genocidal campaign in Sudan.

With witnesses to the Holocaust thankfully still living among us, they serve as a reminder that it is incumbent upon us to do all that is in our power to stop this generation's genocide so that we may actually live to witness, "never again."

#4

Hello- My name is Harriet Shugerman. My husband and I have been residents of Montgomery County for 34 years. Our two sons were educated in our public school system. The schools and culture of this county have informed and inspired our civic activism.

As a Jew, I feel a special responsibility to work to insure that our community and the world responds to the Darfur genocide in a different way than we did to the Holocaust and in Rwanda.

In 2005, I co-founded the Greater Washington Jewish Task Force on Darfur and then the Darfur Interfaith Network. My testimony today is based on my experience with grassroots activists and staff of three major organizations - the Save Darfur Coalition, The Enough Project, and the Genocide Intervention Network.

Over three years ago, Congress passed a resolution condemning the atrocities in Darfur as "genocide" and urged President Bush and the international community to take appropriate action in ending it as soon as possible. However, despite multiple actions and measures by governments and the UN Security Council, the Sudanese government consistently reneges on agreements.

Now, a nation-wide divestment campaign is viewed by many as a critical tactic. Divestment was just about the most effective tool used to end the South African apartheid.

Divestment from Sudan has spread rapidly in the U.S. over the last two years. Over 100 US institutions including 22 states and 58 colleges/universities have divested, including The University of Maryland and The Johns Hopkins University. MCPS is managed with the Maryland State Fund, and has thus already divested.

Montgomery County is one of the most diverse, well-educated, and socially- aware jurisdictions always promoting ethnic tolerance and justice. Do we really want a County budget that receives some of its revenue from such egregious sources? Let's deal with the very real local economic problems facing us, but let's raise revenue from sources consistent with Montgomery County values.

I disagree with some who have raised concern that passage of the Divestment Bill is a slippery slope. Divesting from Sudan does not set a precedent for divesting from other countries or for other causes. This genocide and persecution, on-going even as we speak, presents special circumstances that require special attention.
As long as the mass rape and ethnic cleansing continue in Darfur while we have this substantial and concrete opportunity to affect change, it is very much a Montgomery County issue. Montgomery County should be among those governments willing to employ divestment as a very strong and effective tool. Thank You.
March 4, 2008

Introduced by: Councilmember Clay

**CITY OF TAKOMA PARK, MARYLAND**
**RESOLUTION 2008-19**

**Supporting Divestment from Sudan by Montgomery County**

WHEREAS, the government of the United States and many individuals, organizations and governments have determined that crimes that have taken place in the Darfur region of Sudan are of such magnitude as to constitute genocide; and

WHEREAS, Takoma Park community members have asked the Takoma Park City Council to support efforts to have Montgomery County divest from Sudan as a way to help end the genocide; and

WHEREAS, Montgomery County Bill No. 3-08 would direct the County's Board of Investment Trustees for the Employees' Retirement System to divest from certain companies doing business in Sudan and not make new investments in such companies until 30 days after the President of the United States certifies to Congress that the government of Sudan has honored its commitments to:

1. abide by United Nations Security Council Resolution 1769 (2007);
2. cease attacks on civilians;
3. demobilize and demilitarize the Janjaweed and associated militias;
4. grant free and unfettered access for delivery of humanitarian assistance; and
5. allow for the safe and voluntary return of refugees and internally displaced persons; and

WHEREAS, the Takoma Park City Council supports the goal of bringing the genocide in Sudan to an end.

NOW, THEREFORE, BE IT RESOLVED BY THE COUNCIL OF THE CITY OF TAKOMA PARK, MARYLAND THAT the Council supports Montgomery County Bill 3-08 and urges the Montgomery County Council to adopt the legislation.

Adopted this 25th day of February, 2008.

# KLD INDEXES

# KLD Large Cap Sudan Free Social Index

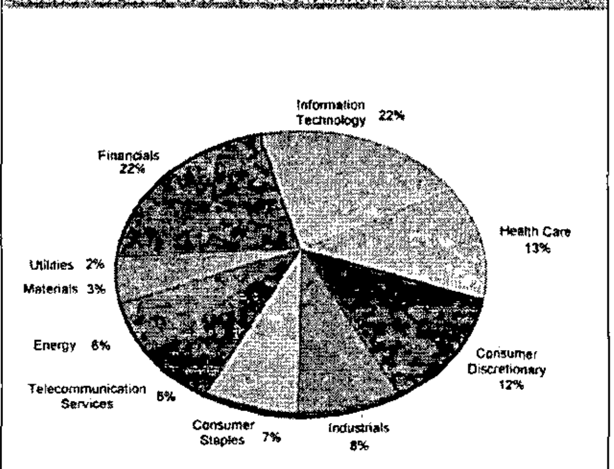
*All data as of September 30, 2007*

| Index Characteristics | LCSFSI | Russell 1000 |
|---|---|---|
| Price/Earnings | 34.97 | 29.09 |
| Price/Book | 5.03 | 4.83 |
| Dividend Yield | 1.64 | 1.71 |
| Beta | 1.00 | 1.00 |
| R-Square | 0.98 | 1.00 |
| Sharpe Ratio | 0.63 | 0.86 |
| Standard Deviation | 2.58 | 2.55 |
| Tracking Error | 0.38 | 0.00 |

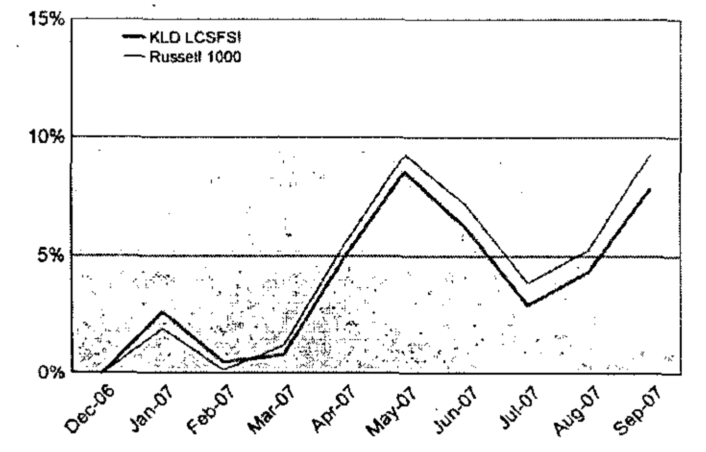
| Market Capitalization ($ Millions) | LCSFSI | Russell 1000 |
|---|---|---|
| Total | 9,574,493 | 16,223,499 |
| Average | 13,485 | 16,047 |
| Median | 5,262 | 5,564 |
| Largest | 276,976 | 513,362 |
| Smallest | 472 | 472 |

| Top 10 Holdings |
|---|
| AT&T Inc. |
| Microsoft Corp. |
| Bank of America Corp. |
| Procter & Gamble Co. |
| Cisco Systems, Inc. |
| Johnson & Johnson |
| International Business Machines Corp. |
| Intel Corp. |
| Hewlett-Packard Co. |
| Apple Inc. |

## Sector Breakdown (GICS Method)




## Cumulative Return (Inception - September 30, 2007)




## Index Performance (%)

| | Month | 3rd Quarter | YTD | One Year | Three Year* | Five Year* | Ten Year* | Since 1/1/07 Inception* |
|---|---|---|---|---|---|---|---|---|
| **LCSFSI** | 3.33 | 1.54 | 7.85 | N/A | N/A | N/A | N/A | 7.85 |
| **Russell 1000** | 3.82 | 1.98 | 9.30 | 16.90 | 13.77 | 15.98 | 6.86 | 9.30 |

*Annualized Returns

Sources: Bloomberg, FactSet Research Systems and Russell Indexes.



KLD LARGE CAP SUDAN FREE
SOCIAL INDEX

# Ex-Sudan Portfolio Performance Comparison

*For Periods Ending June 30, 2007 **

| | ONE YEAR | THREE YEAR | FIVE YEAR |
|---|---|---|---|
| **US EQUITY** | | | |
| Custom S & P 500 x-Sudan | 20.35% | 11.52% | 10.65% |
| S&P 500 Index (Published) | 20.61% | 11.68% | 10.75% |
| Variance vs. Index | -0.26% | -0.16% | -0.10% |
| **NON-US EQUITY** (Developed Markets) | | | |
| Custom MSCI ACW x-US/xSudan | 30.03% | 24.78% | 19.75% |
| MSCI ACW x-US Index (Gross) | 30.14% | 25.02% | 19.85% |
| Variance vs. Index | -0.11% | -0.24% | -0.10% |
| **NON-US EQUITY** (Emerging Markets) | | | |
| Custom MSCI Emerging x-Sudan | 45.13% | 38.18% | 30.23% |
| MSCI Emerging Index (Gross) | 45.41% | 38.66% | 30.65% |
| Variance vs Index (Gross) | -0. 28% | -0.48% | -0.42% |

*Source: Wilshire Consulting

BILL 3-08

CC
SBF
LL
BD

OFFICE OF MANAGEMENT AND BUDGET

Isiah Leggett
*County Executive*

Joseph F. Beach
*Director*

MEMORANDUM 033592

2008 FEB 29 AM 9:38

February 28, 2008

TO: Michael J. Knapp, Council President

FROM: Joseph F. Beach, Director
Office of Management and Budget

SUBJECT: Bill 3-08, Personnel-Retirement-Sudan Investments-Restrictions

The purpose of this memorandum is to transmit a fiscal impact statement to the Council on the subject legislation.

## LEGISLATION SUMMARY

The proposed legislation would prohibit the Employees' Retirement System from investing in the financial instruments issued by specific companies that are doing business in Sudan under certain circumstances. The Bill would require the Board of Investment Trustees to require its investment managers of actively managed separate accounts to divest of certain companies doing business in Sudan in order to influence the Government of Sudan to end the atrocities in Darfur.

## FISCAL SUMMARY

The proposed legislation would require the Board to incur costs in retaining a professional consultant to search for and certify those companies that may have contacts with or ties to the Sudanese government. Additional staff resources would be needed to identify the specific involvement companies have in Sudan to determine if an exemption is warranted, screen the managers' portfolios, obtain and maintain the list of companies, communicate with the investment managers, determine the impact on the portfolio of any divestment action, and prepare reports. Transaction costs would be incurred in the selling of securities and the purchase of replacement securities.

The Trust would also be impacted by potential lower returns which could result in an increase in the County contribution and in the unfunded liability (currently at $700 million). We estimate that a 0.1% decrease in the ERS' investment return equates to an estimated annual

**Office of the Director**

101 Monroe Street, 14th Floor • Rockville, Maryland 20850 • 240-777-2800
www.montgomerycountymd.gov

increase of $2,700,000 in the required County contribution. Based on the analysis prepared by Wilshire Associates, a national consulting firm, the historical performance of major indices, including the S&P 500, MSCI ACWx-US, and the MSCI Emerging Markets, was negatively impacted when companies with ties to Sudan were eliminated (losses range from 0.10% to 0.48% over one, three and five year periods versus the returns of these indices with the companies included). Other sources contributing to possible lower returns include the potential termination of existing investment managers who are unwilling to accept portfolio restrictions and the potential inability to hire future managers who share this view.

The fiscal impact of the legislation is detailed in the chart below. In FY09[1], the Board of Investment Trustees anticipates an additional workload of one-quarter workyear and related operating expenses associated with implementation, including retaining a professional consultant, which cannot be absorbed within the existing budget. All related administrative costs would be funded from the Employees' Retirement System Trust.

**Cost Estimates**

| | **FY09** |
|---|---|
| Board Staff | |
| Board staff support | $15,000 |
| Office expenses | 1,000 |
| Other Expenses | |
| Professional consultant fee | 20,000 |
| Trading costs to divest/reinvest (commisisons, taxes etc.) | 11,000-30,000 |
| Projected Increase in Employer Contributions (due to lost return) | unknown |
| **Total** | **$47,000-$66,000** |

The following contributed to this analysis: Linda Herman, Board of Investment Trustees.

cc: Kathleen Boucher, Assistant Chief Administrative Officer
Linda Herman, BIT
Amy Moskowitz, CAT

[1] Please note that the Board will not be acting on the legislation until after July 1, 2008.

CALVERT SPECIAL REPORT

Partnering to End the Crisis in Darfur

# An Argument for Targeted Divestment

While divestment was an appropriate and effective strategy in isolating South Africa's apartheid regime, questions have arisen as to whether this strategy can work as well in pressuring the government of Sudan to end the violence in Darfur. Some doubt the potential economic impact of divestment and maintain that greater emphasis should be given to political and diplomatic solutions.

Calvert supports the targeted divestment approach as a timely and essential complement to the diplomatic pressures being brought to bear on Sudan. We believe that the divestment campaign can be successful, as it focuses sharply on those companies whose presence in Sudan contributes revenues and capabilities that help the Khartoum regime fund the atrocities in Darfur. The discussion below addresses the reasons for targeted divestment; it is based in part on the Sudan Divestment Task Force (SDTF) March 2006 report, *Arguments for the Efficacy of Targeted Divestment from Sudan*[1].

## The Khartoum regime has been responsive to economic pressure.

According to the SDTF, Sudan's economy grew by 12 percent from 2005 to 2006. Much of this growth was a result of increased foreign direct investment in oil, energy, and other extractive sectors. However, the nation's per capita income was only $640 in 2005. A former Sudanese finance minister reports that instead of aiding the impoverished Sudanese people, the government spends over 70 percent of its oil profits on the military.[2]

But why not urge our government to use diplomacy in order to pressure Sudan? Of course that approach must be taken -- and it is. Political pressure and economic pressure are not mutually exclusive. The Khartoum regime has key international allies, including Russia, China, India, and Malaysia. Both Russia and China sell arms to Sudan and have considerable commercial investments in the country. Although diplomatic leverage is somewhat limited, the international community has nevertheless acted through the UN Security Council to approve deployment of a peacekeeping force -- even though the Sudanese government continues to block it.

However, because it relies heavily upon foreign direct investment, the Sudanese government has responded to economic pressure. When the Canadian oil company Talisman withdrew from Sudan in 2002 in the face of divestment pressure, other oil companies followed. Soon thereafter, the Khartoum regime entered into negotiations that finally ended the country's 21-year civil war. The home countries of companies that continue to do business with the Khartoum regime also experience the effects of divestment. Since some of these companies are state-owned, even Indian and Malaysian oil companies have been affected by the divestment movement, to the point where they have had difficulty acquiring capital that otherwise might be available.

In 2006, the Sudanese Embassy in the United States spoke out against divestment. A subsequent public relations campaign included a 6-page ad in the New York Times promoting Sudan as "a peaceful country" warranting business. These and similar activities indicate that the Sudanese government takes divestment very seriously.

Unfortunately, the Khartoum regime has failed to abide by the Darfur Peace Agreement and refused to allow UN troops into Darfur -- even as the violence and the humanitarian crisis intensify. For these reasons, it is essential not only to intensify diplomatic efforts, but also to bring pressure to bear on the Sudanese government through other means -- especially targeted divestment.

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## Targeted divestment does not penalize those who do need support.

Of course, companies make products beyond those that support warfare. Pharmaceuticals, food, and other products are desperately needed by Sudanese. Therefore, Calvert is engaging in targeted divestment, a process that first establishes which goods and services benefit the Sudanese people and which have the greatest impact on the government's behavior. Decisions to invest or divest follow. For example, companies associated with agriculture, consumer goods, and education are usually exempt under targeted divestment criteria, while oil companies that profit the government directly are most likely to be divestment candidates. As demonstrated by our work with Cummins (CMI), a company in which we invest, Calvert is careful to contact and verify involvement or lack thereof on the part of companies in our funds.

According to the SDTF, "divestment is still likely to disproportionately affect the government of Sudan since Khartoum allocates little government revenue towards social spending." Instead, most development programs are financed largely through international assistance. Therefore, targeted divestment is unlikely to harm those in need, as goods and services will continue flowing through and to the traditional sources that provide aid in Sudan. An example of a company that continues to conduct limited operations in Sudan but is not subject to targeted divestment is 3M (MMM), which sells its Scotchshield Safety and Security Window Film to help protect the vehicles of UN aid workers in Sudan.

## Divestment and recent Darfur developments

In January 2005, the Khartoum regime signed the North-South Comprehensive Peace Agreement (CPA), which ended over 20 years of conflict between the country's Islamic northern region and the southern part of Sudan. However, this agreement did not include Darfur, and the SDTF points out that "implementation of the CPA will provide no economic benefit to Darfur's devastated population or infrastructure." There is also evidence that Khartoum is not living up to the CPA. US Government policy has eased most investment restrictions related to South Sudan, while maintaining a ban on oil investment in the entire country. Targeted divestment promotes strict criteria for oil companies throughout Sudan, but otherwise relaxes standards for most other kinds of investment in South Sudan.

Recently, on January 4, 2007, following dialogues with SDTF and a number of investors, the Swiss engineering firm ABB Ltd. suspended its operations in Sudan, with the exception of those consistent with the UN Global Compact. Prior to this action, ABB had been involved in the building of Sudan's Merowe Dam and had provided support to oil consortiums operating in the country. ABB's suspension of operations shows that the targeted divestment movement can influence companies to halt activities that support the goals of the Khartoum regime. Calvert hopes to see more of these successes.

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As of December 31st, 2006, Cummins (CMI) represented 0.42% of Calvert Social Investment Fund (CSIF) Balanced Portfolio, 0.47% of CVS Calvert Social Balanced Portfolio, 0.99% of CSIF Enhanced Equity Portfolio, 0.07% of Calvert Social Index Fund, 0.26% of Calvert World Values International Equity Fund, and 0.33% of CVS Calvert Social International Equity Portfolio; 3M (MMM) represented 0.95% of CSIF Balanced Portfolio, 1.00% of CVS Calvert Social Balanced Portfolio, 1.35% of CSIF Enhanced Equity Portfolio, 0.69% of Calvert Social Index Fund, 0.90% of CSIF Equity Portfolio, and 0.94% of CVS Calvert Social Equity Portfolio.

1. http://www.sudandivestment.org/docs/effectiveness_of_divestment.pdf
2. Ibid., page 4

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CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE

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# SHOULD PUBLIC PLANS ENGAGE IN SOCIAL INVESTING?

BY ALICIA H. MUNNELL*

## Introduction

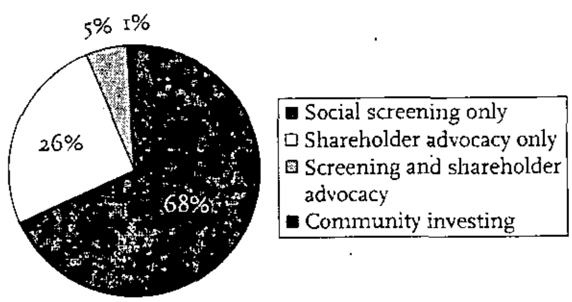
Social investing is a movement that advocates incorporating social and environmental considerations, as well as financial factors, when making investment decisions. The most recent incarnation of this movement is the initiative by state legislatures to force public pension funds to sell their holdings of companies doing business in Sudan. The effort to divest Sudan-linked stocks began in 2004 after the U.S. government characterized the killing and displacement in Darfur province as genocide.[1] Riding on the coattails of the success of the Sudan effort, state legislatures have now targeted Iran, with a goal of "terror-free" investing. The emotional appeal of such actions is powerful. Over 2 million civilians have been displaced and more than 200,000 slaughtered in Darfur since 2003.[2] And Iran refuses to back away from its pursuit of nuclear weapons.[3] But strong arguments also exist against using public pension plans to accomplish foreign policy goals.

This *brief* explores the current world of social investing, the recent efforts regarding the Sudan and Iran, the likely impact of social investing on the target firms, and the reasons why such activity may be inappropriate for public pension plans.

## What Is Social Investing? How Much? Who's Doing It?

Social investing takes three primary forms: 1) screening (either excluding "bad" companies or including "good" companies); 2) shareholder advocacy; and 3) community investing. The Social Investment Forum (SIF), a trade group of social investors, reports that at the end of 2005, in terms of assets under management, screening is by far the most prevalent approach (see Figure 1). Significantly less is involved in shareholder advocacy, and community investing activity is tiny.

FIGURE 1. SOCIAL INVESTING IN THE UNITED STATES BY TYPE OF STRATEGY, 2005




*Source*: Social Investment Forum (2006).

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Table 1. Assets in Socially Screened Portfolios, 1999-2005 (Billions)

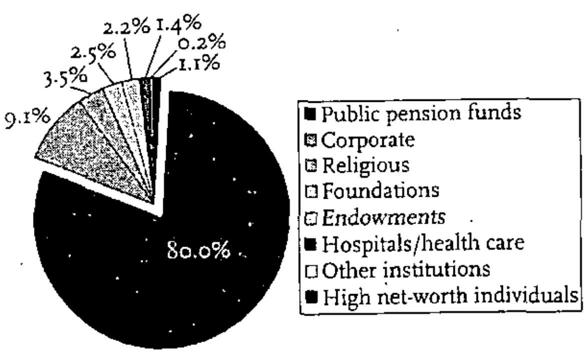
| Year | Mutual funds | Separate accounts | Total |
|---|---|---|---|
| 1995 | $12 | $150 | $162 |
| 1997 | 96 | 433 | 529 |
| 1999 | 154 | 1,343 | 1,497 |
| 2001 | 140 | 1,870 | 2,010 |
| 2003 | 151 | 1,992 | 2,143 |
| 2005 | 179 | 1,506 | 1,685 |

*Source*: Center for Retirement Research at Boston College (2006).

The Social Investment Forum reports that as of the end of 2005, mutual funds with social screens held $179 billion and that socially screened "separate accounts," which are managed for individuals and institutional clients, held $1,506 billion (see Table 1). The SIF calculates that these totals amount to 9.4 percent of all public and private assets under management.

The bulk of the money in separate accounts (80 percent) is the assets of public pension funds (see Figure 2). And screening is pervasive among public funds. The SIF numbers suggest that, in 2005, $1.2 trillion of public pension fund assets were screened by some criteria. These screened assets accounted for 45 percent of total state and local pension holdings in that year.[4]

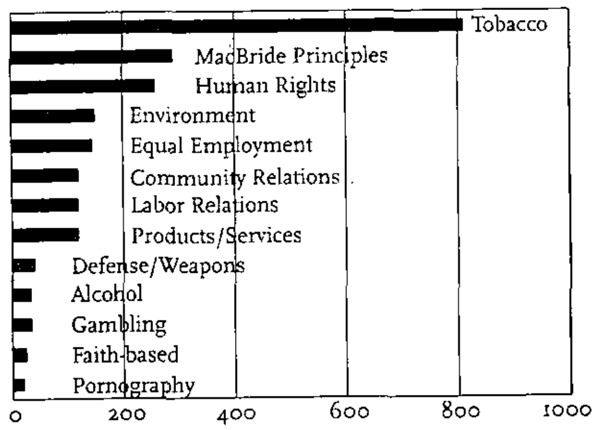
Figure 2. Socially Screened Investor Assets, 2005




*Source*: Social Investment Forum (2006).

The screens vary by the nature of the customer. As of 2005, by far the most popular approach for mutual funds was a negative screen for tobacco; alcohol came in second; gambling third.[5] But the pattern for institutional separate accounts, which is dominated by public plans, is quite different. For these accounts, the MacBride Principles (relating to fair hiring in Northern Ireland), Human Rights, the Environment, and Equal Employment Opportunity ranked among the top social concerns (see Figure 3).

Figure 3. Social Screening by Institutional Investors, 2005 (Billions)




*Source*: Social Investment Forum (2006).

Note that almost none of the screened money is held in private sector defined benefit pension funds.[6] These private plans are covered by the Employee Retirement Income Security Act (ERISA), and right from the beginning the Department of Labor has stringently enforced ERISA's duties of loyalty and prudence.[7] In 1980, the chief administrator of the Department of Labor's pension section published an influential article that warned that the exclusion of investment options would be very hard to defend under ERISA's prudence and loyalty tests.[8] And a 1994 Interpretive Bulletin reminded fiduciaries that they are prohibited from subordinating the interests of participants and beneficiaries ... to unrelated objectives."[9] Thus, ERISA fiduciary law has effectively constrained social investing in private sector defined benefit plans.[10] Social investing is a public pension fund phenomenon.

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# Recent Developments – Sudan and Now Iran

During 2005, and therefore not reflected in Figure 3, state legislatures in Arizona, Illinois, Louisiana, New Jersey, and Oregon passed legislation related to companies with operations in Sudan.[11] Since then some states have branched out to include Iran. And Missouri has taken the lead in initiating an entirely "terror-free" investment policy. American companies have been barred for some time from doing business in either Sudan or with states considered sponsors of terrorism according to the U.S. State Department (Cuba, Iran, North Korea, Sudan and Syria).[12] But in a world of global investing, U.S. investors can have a link to Sudan or "terror states" through foreign stock holdings. Such foreign holdings would be most affected by the recent state legislation.

## *Sudan*

As of August 2007, eighteen states have passed laws regarding divestment of state pension and other funds from Sudan (see Figure 4).[13] Divesting is not easy, however. State and local pension funds tend to invest in global indices, so the exercise involves identifying the companies with links to Sudan and then constructing a Sudan-free index that mimics established benchmarks.

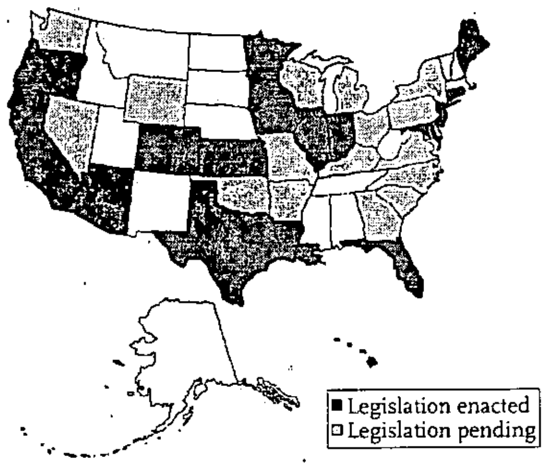
Generally, the states have asked their money managers to figure out which stocks have a Sudan link. Money managers, in turn, have left it to the social investing firms, such as KLD Research and Analytics, Institutional Shareholders Services, and the Conflict Securities Advisory Group to identify companies involved in Sudan. KLD originally said that 124 companies were on its Sudan list, including eight American companies.[14] The social investing firms refuse to make the names public, however, since that is how they earn their money.[15] And apparently, the lists are not definitive. Some companies appeared on the original KLD list even though they were not actually doing business in Sudan. And for at least one, 3M, its involvement was the result of a U.N. purchase of Scotchshield Ultra Safety and Security Film to protect embassy and mission windows from explosions, a transaction that was authorized by the federal government.[16]

The Sudan Divestment Task Force (2007) publishes a more tightly targeted list, recommending the divestment of only 28 companies. These are companies that 1) do business with the Sudanese government; 2) provide little benefit to the disadvantaged of Sudan; and 3) have not developed policies to prevent their business activities from inadvertently contributing to the government's genocide capability.

Fund managers take the Sudan-link list and attempt to construct "Sudan Free" funds that mimic popular benchmarks. This step is also a challenge. According to the chief investment strategist at Northern Trust, whose fund tracks the Morgan Stanley Capital International Europe Australasia Far East index (MSCI EAFE) index, constructing a "Sudan-free" index will require divesting 25 companies or 9 percent of assets.[17]

Despite the challenges involved, public funds have moved $2.2 billion away from Sudan-linked companies between 2005 and 2007.[18]

Figure 4. States that Have Enacted or Are Considering Sudan Divestment Legislation, 2007




*Sources*: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); Sudan Divestment Task Force (2007); State of Arizona (2005), State of Arkansas (2007); and State of Louisiana (2005 and 2007).

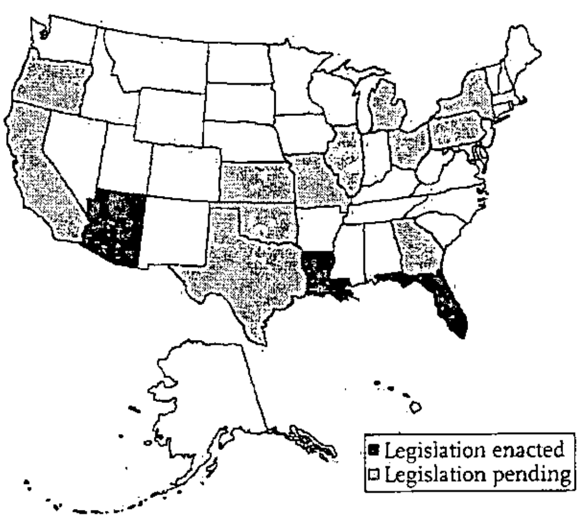
## *Iran*

More recently, "terror-free" investment has been picking up steam. The primary targets are companies doing business in Iran.[19] As noted above, U.S. companies have long been barred from operating in Iran, but more than 200 multinationals have investments there, from Royal Dutch Shell and France's telecommunications-equipment company Alcatel to Sweden's electronics company Ericsson.[20]

On June 8, 2007, Florida's governor signed a Sudan and Iran Divestiture bill into law. Florida follows other states with regard to Sudan, but is the first to enact divestiture legislation for companies doing business with Iran.[21] Louisiana, which had passed "terror-free investing" legislation in 2005, permits — but does not require — divestment. Arizona, which also passed legislation in 2005, only requires the public retirement system to disclose investments in terror-linked companies. In Illinois, the state Senate passed an Iran divestment bill on June 14, 2007 which would compel the state's five retirement systems to divest Iran-connected companies in energy and other natural resources.[22] California, Georgia, Kansas, Michigan, Missouri, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, and Texas are also considering adopting Iran-free investing (see Figure 5).[23]

If some of the bills are passed in their broadest form, institutions may be forced to sell $18 billion in investments.[24] Selling all Iran-related securities would add substantial risk to an indexed international equity portfolio. State Street Global Advisors (SSgA), Boston, has had preliminary conversations with clients about Iran divestments. SSgA estimates that if all companies with ties to Iran were removed from Morgan Stanley's EAFE index and replaced with similar performing companies, it would introduce a tracking error of up to 200 basis points, compared to the tracking error on a typical index of between five and 10 basis points.[25]

Figure 5. States that Have Enacted or Are Considering Iran Divestment Legislation, 2007




*Sources*: National Conference of State Legislatures (2007); Office of Missouri State Treasurer (2005); State of Arizona (2005), and State of Louisiana (2005 and 2007).

Some state legislatures, however, are limiting the scope of divestiture to energy-related stocks, arguing that such action is likely to be most effective in curbing terrorist activities. Narrowing the scope greatly reduces the number of stocks and amount that would have to be sold.[26]

Iran is a more politically complicated issue than Sudan. Sometimes promoters of "divest Iran" suggest that the effort is aimed at Al Qaeda.[27] But Al Qaeda is an enemy without a state and therefore difficult to target. In addition, the U.S. government is not enthusiastic about the effort, because it is working on its own initiative with allies to curtail business transactions tied to nuclear activities and support for terrorism. Treasury and State Department officials have expressed concern that broad-based divestiture could cause a backlash if allies feel that a wide range of companies is under attack.[28]

Despite the complexities involved with Iran, some states have gone even further and are pursuing "terror-free" investing, which extends the scope of the boycott to all the countries on the U.S. State Department's State Sponsors of Terrorism list, which includes Cuba, Syria, and North Korea. Missouri has been at the forefront of this movement. The State Treasurer claims that at least 500 big foreign companies and multinationals do at least some business in countries identified as sponsoring terrorism.[29] The Treasurer's goal is to have all Missouri's investments "terror-free," although the state legislature has not yet passed divestiture legislation for the state pension funds.[30] Anti-terrorism bills have been enacted in Arizona, Florida, and Louisiana.

Given the substantial amount of social investing by public pension funds, it is useful to consider the likely impact of such activity on the targets of the social screen and the likely impact on the pension funds themselves.

# The Economics of Social Investing

The academic literature suggests that social screens are likely to have very little impact on the target company and that the impact on the pension fund depends on the scale of the screen.

## *Impact on Targeted Company*

The SIF Report suggests that social investing will have a financial impact — that investors are putting their money to work in ways that will build "a better, more just, and sustainable economy." The academic literature on the stock market, however, suggests the opposite. And a comprehensive survey on the effect of the South African boycott — the largest and most visible social action — documents virtually no effect, suggesting the real world mirrors the textbook model.

*Injecting politics into pension policy is problematic.*

According to standard finance theory, the price of any stock equals the present discounted value of expected future cash flows. Thus, the stock of a particular firm has a lot of close substitutes, which makes the demand curve for a particular stock, in economists' terms, almost perfectly elastic.[31] That is, even a big change in quantity demanded will lead to only a small change in price. And any significant deviation from the fundamental price would represent a profitable trading opportunity that market participants would quickly exploit and thus correct.[32] In other words, boycotting tobacco stocks or international companies doing business in Sudan or Iran may result in a temporary fall in the stock price, but as long as some buyers remain they can swoop in, purchase the stock, and make money. And the buyers are out there. The "Vice Fund," which was established in September 2002, specializes in only four sectors — alcohol, tobacco, arms, and gambling, and thus stands ready to buy the stocks screened out of standard portfolios.[33] Thus, the textbooks suggest that boycotting tobacco companies or international companies doing business in Iran is unlikely to have any impact on the price of their stocks.

A 1999 study took a comprehensive look at how equity prices responded to sanctions and pressures for firms to divest their holdings in South Africa.[34] The conclusion that emerges from a series of event studies is that the anti-apartheid shareholder and legislative boycotts had no negative effect on the valuation of banks or corporations with South African operations or on the South African financial markets. This is not to say that the boycott was not important politically, but merely that it did not impact financial markets. The study looks at pressure put on firms from both congressional action and divestiture by pension funds and universities.

The bulk of the congressional action occurred in 1985 and 1986, when the U.S. government passed legislation imposing trade embargoes, currency sanctions, and lending restrictions. Most importantly, the Comprehensive Anti-Apartheid Act of 1986 prohibited new private or public loans to South Africa other than for humanitarian purposes. To test the impact of this prohibition, the study identified ten important legislative events leading up to the 1986 Act and examined their impact on a portfolio of nine banks with South African loans. The results showed few significant effects on bank stock prices and where significant they were of the wrong sign.

Pension funds and universities also put pressure on corporations. Pension fund involvement in the South African issue began when a number of churches threatened to divest from banks doing business in South Africa. In 1977, the first iteration of the "Sullivan principles," which called for non-segregation of races and equal pay for equal work, was adopted in the hope that by adhering to these principles, companies could continue doing business in South Africa and at the same time promote non-discrimination policies.[35] But many felt that the Sullivan principles did not go far enough, so Reverend Sullivan called in 1987 for companies to withdraw completely from South Africa. Many funds began to divest themselves even of companies that had followed these principles.[36] The study looked at the effect of 16 pension fund divestments on a portfolio of firms with the highest exposure in South Africa. The results showed no evidence that the pension fund divestment announcements hurt firms with major South African operations.

In short, financial textbooks characterize the demand curves for individual stock as infinitely elastic, so the price of the stock of a targeted company is unlikely to be affected by a boycott so long as additional buyers remain to scoop up the profit opportunity. The fact that an effort as large as the boycott of firms doing business in South Africa had virtually no effect on stock prices suggests that the financial effect of social investing on target firms is roughly zero.

## *Impact on the Pension Fund*

But does social investing affect the pension fund adversely? Modern portfolio theory states that investors should diversify their asset holdings over a variety of securities, so that the returns on all financial assets do not move in lockstep.[37] The question is how many securities are needed for the portfolio to be efficient? The answer is that an investor needs only 20-30 stocks to construct a fully diversified portfolio.[38] The small number of required stocks suggests that eliminating, say, tobacco, which accounts for about 1 percent of the market capitalization of the S&P 500, should leave enough securities to construct something very, very close to the market index. As the number excluded increases, it would become increasingly difficult to duplicate the market.[39]

In terms of evidence, considerable research has compared the risk-adjusted return of screened portfolios to the return of unscreened portfolios. Most of the studies cover the period since the mid-1980s. Overall, the results show that the differences in risk-adjusted returns between the screened portfolios and unscreened portfolios are negligible and in most cases zero.[40] A few studies have focused on the effects of divestiture of tobacco stocks in the 1990s and show that the risk and returns for the S&P 500 with and without tobacco stocks were almost identical.[41]

In addition to comparing the performance of screened portfolios to the S&P 500, several studies have examined the performance of social investment funds relative to the S&P 500. The Domini Social Index includes 400 U.S. companies that pass multiple and broad-based social screens, and the Calvert Social Index is a broad-based index including 659 companies. The majority of these studies show that socially screened funds have no significant effect on risk-adjusted returns.[42]

In contrast, the evidence from the early days of the South Africa divestiture suggested that screening out stocks meant large losses. For example, in the 1970s, Princeton University reported that the stocks that had been excluded because of South Africa ties outperformed other holdings by 3 percent.[43] As time passed and researchers undertook more comprehensive studies, the conclusions shifted. For example, one study examined the performance of a South-Africa free portfolio compared to an unscreened NYSE portfolio for the period 1960-1983 and found that, after adjusting for risk, the portfolio excluding South Africa companies actually performed better than the unscreened portfolio.[44] The positive results occurred because companies with South Africa ties were large and excluding these companies increased reliance on small-cap stocks, which performed better on a risk-adjusted basis during this period. During the late 1980s, the results were also mixed. On the one hand, a 1998 study analyzed data from the Surveys of State and Local Employees (PENDAT) from the early 1990s and found no significant effect on returns from restrictions on South Africa investments.[45] On the other hand, the S&P 500 including South Africa stocks performed slightly better than the index without the stocks, and one study of public pension plans found that South Africa restrictions had a negative effect on returns.[46] Thus, a large divestiture movement could have some negative effect on returns earned by public plans.

*State actions may conflict with federal foreign policy.*

Another aspect that has received less attention is the administrative costs of social investing. It is possible that social investing is associated with higher fees and therefore has lower net returns because additional resources are required by fund managers to do the screening. The 2003 SIF Report concluded that socially responsible funds appear as competitive as other funds when it comes to administrative costs. However, others challenge this view by pointing out that some of the large-cap social index funds have above-average fees.[47] Moreover, in the case of Sudan and Iran, constructing new indices to match existing benchmarks involves substantial costs.

In short, theoretical models of portfolio choice imply that restricting the portfolio to socially responsible investments could have an effect on the rate of return by limiting the ability to diversify. Given the large number of stocks available, however, the cost — using traditional asset pricing models — is likely to be negligible. The bulk of the studies, which compare risk-adjusted returns for socially screened portfolios to those of unrestricted portfolios, supports this claim. Although a "terror-free" effort as large as the South African divestiture may have had some effect.[48] And administrative costs may be an important issue.

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# Public Plans Are Not Suited to Social Investing

In the late 1970s, some observers identified the large and rapidly growing funds in state and local pension plans as a mechanism for achieving socially and politically desirable objectives. The initial debate focused on attempts to exclude from pension portfolios companies with specific characteristics, such as those with almost totally nonunion workforces or investments in South Africa. The focus quickly shifted to undertaking pension investments that would foster social goals such as economic development and home ownership.[49] Advocates generally contended that the broader goals could be achieved without any loss of return.

Early reports, however, suggested that the targeting did involve sacrificing return. For example, a 1983 study of state-administered pension funds showed that many states had purchased publicly or privately insured mortgage-backed pass-through securities to increase homeownership in their state.[50] Analysis of the risk/return characteristics of these targeted mortgage investments revealed that 10 states either inadvertently or deliberately had sacrificed as much as 200 basis points to foster homeownership. Similarly, in 1992, Connecticut's state pension fund lost $25 million attempting to shore up Colt Industries. The firm went bankrupt two years after the fund bought a 47 percent interest in an attempt to protect Connecticut jobs.[51] In Kansas, the state pension fund lost between $100 and $200 million on defaulted loans from an in-state investment program that included a chain of video stores, a steel mill, and a failed savings and loan bank.[52] State and local pension funds were on a naïve and dangerous path.[53]

The losses in the 1980s and early 1990s were a sharp wake-up call to a number of public pension fund managers who appeared to believe that they could accomplish social goals without sacrificing returns. Over the last 20 years, the rhetoric associated with targeted investments has changed markedly. Public pension fund managers, sensitive to the potential for losses, go out of their way to make clear that they are no longer willing to sacrifice returns for social considerations; almost every definition of social investing includes a requirement that the investment produce a "market rate of return."

*Divestment can be complicated, costly, and ineffective.*

In the recent debate regarding Sudan and Iran, trustees of public plans have spoken out opposing such initiatives. Administrators at California's large public pension funds — CalPERS and CalSTERS — oppose the California bills requiring divestiture. A CalPERS spokesman said that determining which companies have dealings with Iran would be a struggle: "We don't necessarily have the resources or the expertise."[54] Similarly, the executive director of Massachusetts' Pension Reserves Investment Management Board, which invests public plan assets, said "You hire us to make you money, and when you restrict our ability to pick stocks, you likely restrict our ability to get returns."[55] Ohio's legislature initially considered following the Missouri model making investments "terror-free" by filtering out all stocks with links to North Korea, Syria, Sudan or Iran. The pension fund administrators argued that the measure would affect stocks of more than 170 companies and require the funds to sell more than $9 billion. Administrative costs would exceed $60 million.[56]

Moreover, legislative mandates for pension fund investing may have implications elsewhere in the state. For example, in the case of Ohio the "terror-free" investing bill would have roped in companies such as Honda, DaimlerChrsyler AG, Bridgestone Corporation, Siemens, and Thyssenkrupp AG, all of which had investments in Ohio.[57] The pension funds estimated these companies employed more than 45,000 workers. In response, the legislature narrowed the scope of the effort and decided to go after only those companies with more than $20 million in Iran's energy sector.[58]

Most importantly, three aspects of public pension funds make them particularly ill-suited vehicles for social investing.

First, the decision-makers and the stakeholders are not the same people. The decision-makers are either the fund board or the state legislature. The stakeholders are tomorrow's beneficiaries and/or taxpayers. If social investing produces losses either through higher administrative costs or lower returns, tomorrow's taxpayers will have to ante up or future retirees will receive lower benefits. The welfare of these future actors is not well represented in the decision-making process.

Second, whereas the investment practices of many large public funds are first rate, other boards are much less experienced. The boards of smaller funds often consist of between five and eleven people including mayors, treasurers, comptrollers, city councilors, union leaders, and citizens. The process is often conducted behind closed doors and subject to little public scrutiny. Moreover, many state and local plans are still run in-house and involve the selection of individual stocks rather than broad-based indices. A front page *New York Times* article reported that political money sometimes affects pension investment decisions. As a result, pension boards may overlook excessive fees or high rates of turnover, and they may approve inappropriate investments.[59] Introducing divestment requirements into such an environment is problematic.

The final issue is the slippery slope. This round of divestment began with Sudan and involved only a few stocks. It is quickly spreading to Iran, where the issues are even more complicated and the number of companies substantially greater. If "terror-free" investing gains momentum, what is going to stop the spread to, say, Saudi Arabia, original home of 15 of the 19 hijackers involved in the 9/11 terrorist attacks? At some point, the administrative costs of broad-based divestiture will balloon and excluding large numbers of companies will definitely hurt returns.

## Conclusion

Everyone is horrified by genocide, and no one wants to support terror. Yet even those who sell socially responsible funds admit that the issue of divestiture is complex. "You have to ask yourself what your goal is with divestment. What's there if the government falls? Is there a government there that will take over and be better? If the companies that pull out provide money, goods, and services, is there an understanding that will make the people poorer in the short run?"[60] Yes, the regime changed in South Africa, but many South Africans say that it was the cultural boycott — particularly in sports — rather than the divestiture of companies with South-Africa-linked activities that resulted in the peaceful ascendance of Nelson Mandela as president.[61]

In addition to the issue of effectiveness, the fundamental question is where foreign policy should be made. Sudan does not raise as many issues in this regard as Iran. The State Department is working closely with foreign governments to get specific companies to stop selected activities, particularly in Iran's energy sector. Additionally, in more than one instance, federal courts have ruled that state legislation regarding social investment was unconstitutional on grounds that it overlapped with federal regulations.[62] Statements by officials at both Treasury and the State Department make clear their concern that a broad-based divestiture could disrupt the government's effort.

But even assuming that divestment is an effective mechanism to stop genocide and reduce terror risk and that state legislatures and pension fund boards are the right place to make foreign policy, the issue remains whether pension funds are an appropriate vehicle for implementing that policy. The answer seems unquestionably "no." The decision-makers are not the people who will bear the brunt of any losses; rather they will accrue to future beneficiaries and/or taxpayers. In many instances, the environment surrounding public pension fund investing is politically charged and encouraging public pension fund trustees to take "their eyes off the prize" of the maximum return for any given level of risk is asking for trouble. And finally, boycotting companies doing business with particular countries is a slippery slope — today Sudan and Iran, tomorrow Saudi Arabia.

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# Endnotes

1 Actually, as early as 2000, many college endowments and public pension funds, including CalPERS, did not participate in the initial public offering of PetroChina, because of its involvement in oil extraction in Sudan. See Fried (2006).

2 Amnesty International (2007) and Hagan and Pallioni (2006).

3 U.S. Department of Treasury (2007).

4 The Federal Reserve Flow of Funds reports total assets for state and local pension plans of $2,701.5 billion in 2005.

5 The majority of funds (64 percent) use 5 or more screens; the remainder are divided between those with a single screen (25 percent) and those with 2-4 screens (11 percent).

6 Multi-employer plans have made a few efforts to stimulate demand for union labor, especially in the construction trades. And some health care companies and hospitals screen for tobacco. But generally very little social investment has taken place. The Social Investing Forum (SIF), however, has reported that nearly 10 percent, or $137 billion, of screened assets are in corporate defined benefit plans. It was impossible for the author to ferret out where this money was. The only corporation mentioned by SIF was the Federal Home Loan and Mortgage Corporation (Freddie Mac). Since Freddie Mac invests most of its money in home mortgages, it is not clear how it is involved in social screening. In a personal communication, SIF's Joshua Humphreys said that there are other corporations that are not included on the list, but SIF refused to give out any additional names.

7 ERISA requires a fiduciary to act "solely in the interests of the [plan] participants and beneficiaries... for the exclusive purpose" of providing benefits to them. A fiduciary must also act "with the care, skill, prudence, and diligence" of the traditional "prudent man." See Langbein, Stabile, and Wolk (2006).

8 Lanoff (1980).

9 U.S Department of Labor (1994).

10 Some companies offer their employees one or more mutual fund options that pursue social investing criteria. Such an option does not raise any fiduciary concerns because the decision is left entirely to the participant.

11 The New Jersey legislation requires its pension funds to divest holdings in businesses that have equity stakes in the Sudan. A similar bill in Illinois, enacted in June 2005, provides that a fiduciary should not transact any business with a company doing business with Sudan, although in February 2007 the Federal District Court for the Northern District of Illinois ruled this act unconstitutional. Oregon also passed such a law for its public pension funds, while Louisiana legislation permits, but does not require, divestiture of investments linked to the Sudan.

12 U.S. Department of State (2007a). In 1997, President Clinton issued an executive order barring companies from conducting business in the Sudan; foreign businesses do not fall under that restriction.

13 For example, Texas legislation, signed into law on June 15, 2007, will require both the Teacher Retirement System and the Texas Employees Retirement System to ask affected companies to cease business in Sudan and to divest shares of unresponsive companies. The Hawaiian Employees' Retirement System was required to divest from Sudan-related investments when legislation went into effect July 1st. In Connecticut, legislation enables the Treasurer to divest state funds invested in companies doing business in Sudan or decide against further or future investments. Nineteen other states have pending divestment legislation or are taking other actions towards divestment. For example, the New York State Comptroller adopted a targeted Sudan divestment policy for the New York State Common Retirement Fund.

14 Fried (2006).

15 A KLD employee told us that KLD sells their compliance list to institutional money managers who are interested in social divestment and that it is not in the company's best interest to allow outside organizations to obtain their list in whole or in part. KLD also would not provide information about the American companies on the list. This information was obtained through a personal communication with KLD's Randy O'Neill.

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16 Fried (2006). In a personal communication, 3M's Jacqueline Berry also confirmed the sale of the Security Film to the United Nations.

17 Fried (2006) and a personal communication with Northern Trust's Priya Khetarpal.

18 Pichardo (2007).

19 The U.S. House Financial Services Committee on May 23, 2007 passed legislation that would protect public pension funds and their money managers from litigation in response to Iranian divestiture.

20 King (2007).

21 The new law requires the State's Board of Administration to contact companies with business ties to Sudan and with energy ties in Iran, asking them to stop such activities; unresponsive companies would have to be divested 90 days after the communication. See Pensions and Investments (2007a).

22 *Pensions and Investments* (2007b).

23 The California legislation, which was proposed in January and as of July is still in committee in the state senate, would force two of the nation's largest pension funds — for the state's public employees and teachers, with combined holdings of $400 billion — to remove their money from any foreign company doing business with Iran. See Abdollah (2007).

24 Pichardo (2007).

25 See Pichardo (2007); and also confirmed by a personal communication with SSgA's Gary Conway. Also, according to Northern Trust Global Investments, companies doing business in Iran comprise about 25 percent of the MSCI EAFE index, compared to about 15 percent with ties to Sudan.

26 When narrowed, the number of companies involved declines from 100-125 to the 19-25 range. In California, for example, CalPERS would have to divest $8 billion if a bill introduced by Joel Anderson is passed. If narrowed to companies only with energy interests in Iran, the divestiture requirement drops to $2 billion. See Pichardo (2007).

27 LaFranchi (2007).

28 See U.S. Department of Treasury (2007); U.S. Department of State (2007b); and McKinley (2007).

29 Karmin (2007).

30 See Frick (2007).

31 For a summary of the literature on testing the extent to which the supply curve is elastic, see Munnell and Sundén (2005).

32 The caveat is, of course, that potential buyers must not think the sale (purchase) reflects a negative (positive) assessment of the firm's financial condition or business prospects that could affect future cash flows. If potential purchasers believe that the seller is disposing of the stock because he knows something adverse they do not, they will revise down their assessment of the stock's value, and the transaction will reduce the price of the stock.

33 Apparently the Vice Fund has grown at 20 percent annually since its inception, outpacing the S&P's growth of 16 percent. At first blush, these results appear to contradict the conclusion that screening has no impact, but the period under consideration is far too short for these numbers to have meaningful implications. See Authers (2007).

34 Teoh, Welch, and Wazzan (1999).

35 During the 1970s, as opposition against the apartheid government increased, social activists charged that companies investing in South Africa indirectly supported the government and its discrimination policies. In an initial effort to resolve the conflict, the Reverend Leon Sullivan in 1977 introduced a set of guidelines for companies doing business in South Africa, the so-called "Sullivan Principles." By 1987, 127 U.S. companies had signed on to the Sullivan principles (Auerbach, 1987).

36 For example, CalPERS divested itself of $9.5 billion worth of shares of companies holding a South African subsidiary. Pressure to divest and a worsening economic and political environment in South Africa led many companies (IBM, Exxon, Ford, GM and Chrysler) to sell their holdings. See Teoh, Welch, and Wazzan (1999).

37 An asset can be characterized by its expected return and the risk associated with that return, measured by the variance in returns. The risk of a specific asset can be broken down into two parts: risks that are unique to that stock (firm risk) and risks that stem from market-wide variations such as business cycle variation, inflation, and interest rate fluctuations

(market risk). When assets are combined in a portfolio, the return on the overall portfolio is given by the average return of the assets. And the risk associated with the portfolio is determined by the variance of the individual returns and the degree to which the individual returns vary together (covariance). Thus, by combining assets into a portfolio that have differing risk characteristics, an investor can create an efficient portfolio — a portfolio that is expected to achieve a given level of expected returns while minimizing risk.

38 Assume an investor plans to divide his money among $n$ stocks selected from the entire market portfolio. The portfolio variance is given by:

$$\text{Portfolio variance} = 1/n * \text{average variance} + (1 - 1/n) * \text{average covariance}$$

As the number of securities in the portfolio increases, the contribution to total risk from the individual firm-specific risk decreases and the contribution from how the risks vary in relation to each other (covariance) increases. Thus, as the number of securities increases, the overall portfolio variance approaches the economy-wide risk, represented by the second term in the equation. With 2 stocks in the portfolio, half of the overall variance is due to firm specific risk and half to market risk. By the time a portfolio contains 10 securities, 90 percent of the portfolio's variance should be determined by the market risk. With a 20 stock portfolio, 95 percent of the variance should be determined by the overall market risk. See Brearley and Myers (1988).

39 Rudd (1981) and Grossman and Sharpe (1986) argue that the investor will not be able to exactly duplicate the market portfolio, because the screened portfolio will have relatively greater covariation in returns. Rudd also argued that social investing will introduce size and other biases into the portfolio, which will lead to a deterioration in long-run performance.

40 Guerard (1997); Hamilton, Jo, and Statman (1993); Statman (2000); Bauer, Koedijk, and Otten (2002); Dhrymes (1998); and Bello (2005). A similar result has been found for bond portfolios (D'Antonio, Johnsen and Hutton, 1997).

41 DiBartolomeo (2000). In the late 1980s and early 1990s, tobacco stocks performed slightly better than the S&P 500 but during the second half of the 1990s the tobacco stocks underperformed the S&P 500 on a risk-adjusted basis (Social Investment Forum, 1999; and Ferrari, 2000). However, the overall effect of divesting tobacco stocks should be small because they only account for about 1 percent of the S&P 500.

42 Kurtz and DiBartolomeo (1996); DiBartolomeo and Kurtz (1999); DiBartolomeo (1996); and Bello (2005). Some critics of these results contend that the comparable returns reflect the fact that the screened funds invest a higher proportion of their assets in small cap stocks. Small caps have out-performed large caps over the period 1995 to 2007 by more than 3 percentage points (10.9 percent versus 7.8 percent). The discrepancy since the trough in the market in 2002 has been even greater (20.0 percent versus 11.0 percent). Bello (2005) contends, however, that the sizes of the companies in the screened and unscreened portfolios are very similar.

43 Malkiel (1991).

44 Grossman and Sharpe (1986).

45 Munnell and Sundén (2001).

46 Romano (1993).

47 Hickey (2000).

48 A recent study (Karolyi, 2007) of terror-free investing concluded that there were no significant differences in risk or return of stock portfolios screened on the basis of their operations in countries designated as state sponsors of terrorism and the S&P 500. This study, however, focused exclusively on U.S. markets, where very few firms do business in terror-linked countries. The author notes that "Broadening the analysis to incorporate a global investment strategy may render different results and conclusions."

49 Two books were instrumental to broadening the social investing debate — Rifkin and Barber (1978) and Litvak (1981).

50 Munnell (1983).

51 Schwimmer (1992); and Langbein, Stabile, and Wolk (2006).

52 White (1991).

53 In their initial forays into economically targeted investments, public pension fund managers generally

did not appear to recognize the "Catch-22" nature of the exercise. For the most part, the goals of increasing in-state housing investment and maximizing returns are inconsistent in the United States' highly developed capital markets. Any housing investment that offers a competitive return at an appropriate level of risk, such as a GNMA, does not need special consideration by public pension plans nor would such consideration increase the long-run supply of mortgage loans. Investments by pension funds that would increase the supply of housing funds must by definition either produce lower returns or involve greater risk. Sophisticated advocates of targeted investments recognized the efficiency of the market for housing finance and argued that pension funds could make a contribution through innovative forms of housing finance. But that was not what was going on in 1983; the in-state mortgages purchased by public pension funds tended to be conventional fixed-rate 30-year mortgages. See Munnell (1983).

54 McKinley (2007) and also confirmed by a personal communication with CalPERS' Brad Pacheco.

55 Mishra (2006).

56 King (2007).

57 Ohio Retirement Study Council (2007).

58 King (2007).

59 Walsh (2004).

60 The comment is from Julie Gorte, director of social research at Calvert Investments (Fried, 2006).

61 Authers (2007).

62 Stern (2007).

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OFFICE OF THE COUNTY ATTORNEY

Isiah Leggett
*County Executive*

Leon Rodriguez
*County Attorney*

# MEMORANDUM

TO: Linda Herman

CC: Kathleen Boucher
Rebecca Domaruk

THRU: Marc Hansen

FROM: Amy Moskowitz

DATE: February 26, 2008

RE: Bill 3-08

Our office was asked to comment on Bill 3-08. Bill 3-08 adds Section 33-60A to the County Code and requires the Board of Investment Trustees to divest investments from companies "doing business in Sudan" from separately managed accounts.

On December 31, 2007, President Bush signed into law the Sudan Accountability and Divestment Act of 2007 (the "Act"). This law permits State and local governments to divest from certain companies with business relationships in Sudan and provides that Federal law will not preempt State and local laws which meet the Act's requirements. Bill 3-08 meets the requirement of the federal law with one exception. The Act requires a government who implements the standards set forth in the Act to notify the Attorney General within 30 days. Bill 3-08 does not contain this requirement. We suggest adding this requirement as an uncodified provision.

The Act also provides that fiduciaries under the Employees Retirement Income Security Act (ERISA) may only divest if they act in accordance with Department of Labor regulations for economically targeted investments. Although ERISA does not apply to the County's retirement plans, the County Code provides that the Board of Investment Trustees must meet the same standard of care as ERISA fiduciaries, most notably the duty of loyalty and the duty of prudence. The Department of Labor interprets ERISA's duty of loyalty to prohibit fiduciaries "from

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subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." The Department of Labor interprets (most significantly in its 1994 Interpretive Bulletin) the duty of prudence to prohibit investment decisions from being influenced by non economic factors unless the investment ultimately chosen for the plan, when judged solely on the basis of its economic value, would be equal to or superior to alternative available investments. The Act provides that ERISA fiduciaries are still subject to the Department of Labor interpretation of economically targeted investments set forth in the 1994 Interpretive Bulletin. Therefore, because County law uses the same standard of care, it may be presumed that the County should adhere to the Department of Labor's interpretation which Bill 3-08 does not provide. However, applying the Department of Labor standard (i.e., determining if an investment is equal to or superior to an investment) may be difficult or impossible for the Board to determine. The Bill should clarify if the Council intends that the Board must ignore the currently applicable prudent investor standard in order to divest the fund of investments in companies that conduct business with Sudan.

In 1989 the Maryland Court of Appeals in the Board of Trustees of the Employees' Retirement System of the City of Baltimore v. Mayor and City Council of Baltimore City, 317 Md. 72, held that legislation requiring divestment of investments in South Africa did not interfere with the Board's fiduciary duties because of certain factors, the most significant factor being that the cost of the social investing was de minimis. The initial cost of divestment was \$750,000, or $1/16^{th}$ of 1% of the fund's value. The on going cost was \$1.2 million per year, or $1/10^{th}$ of 1% of the funds total value.

Therefore, under the 1989 court case, if the impact to the ERS could be considered de minimis, the standard under the Baltimore City case would be met. However, as noted, the Department of Labor released guidance subsequent to the Baltimore City case providing additional guidance regarding investments using non economic factors. Although the Department of Labor guidance is not binding on the County, it is unclear the impact of the Department of Labor guidance would have on a court deciding this issue because the standard of care the County uses is the same standard used in ERISA. Again, the Bill should expressly state if the Council intends that the Board is authorized to ignore the prudent investor standard in order to comply with the divestment requirement of the legislation.

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CFR Code of Federal Regulations Pertaining to U.S. Department of Labor
Title 29 Labor
Chapter XXV Pension and Welfare Benefits Administration, Department of Labor
Part 2509 Interpretive Bulletins Relating to the Employee Retirement Income Security Act of 1974

# 29 CFR 2509.94-1 - Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

- **Section Number:** 2509.94-1
- **Section Name:** Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor's interpretation of sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in ``economically targeted investments'' (ETIs), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. Sections 403 and 404, in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a-1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the

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above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate section 404(a)(1)(A) and (B) and the exclusive purpose requirements of section 403.
[59 FR 32607, June 23, 1994]

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